SUPREME COURT, U. S.

FILED

JAN 2 1969

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

Nos. 894

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

CHARLES HEIT, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

BETTY VOLK, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

STANLEY R. GRANT, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, CARL M. LOEB, RHOADES & CO., a partnership, and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

HELEN HOWARD and WALTER V. TYMINSKI,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Of Counsel:
CAHILL, GORDON, SONNETT, REINDEL & OHL
DAVID R. HYDE
IMMANUEL KOHN
80 Pine Street
New York, New York 10005

Of Counsel:
CARTER, LEDYARD & MILBURN
JOHN F. X. PELOSO
2 Wall Street
New York, New York 10005

Of Counsel:
KOSTELANETZ & RITHOLZ
52 Wall Street
New York, New York 10005

Of Counsel:
MENDES & MOUNT
JOHN F. BYRNE
27 William Street
New York, New York 10005

JOHN F. SONNETT
80 Pine Street
New York, New York 10005
Attorney for Petitioners Stanley R. Grant and Carl M. Loeb, Rhoades & Co.

DEVEREUX MILBURN
2 Wall Street
New York, New York 10005
Attorney for Petitioners Edward H. Weitzen and Jack J. Fischer

BORIS KOSTELANETZ
52 Wall Street
New York, New York 10005
Attorney for Petitioner Belock Instrument Corporation

WILBUR H. HECHT
27 William Street
New York, New York 10005
Attorney for Petitioner Lybrand, Ross Bros. & Montgomery

January 2, 1969

INDEX

PAGE

Opinions Below 2

Jurisdiction 2

Question Presented 3

Statute and Rule Involved 4

Statement of the Case 5

Reasons for Granting the Writ 11

Conclusion 19

Appendix

A. Opinion of Court of Appeals 1a

B. Opinion of District Court (Heit and Volk Cases) 1b

C. Opinion of District Court (Howard Case) 1c

Table of Authorities

Cases

Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951) 16

SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) 15, 16

SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) 2, 3, 7, 14, 15, 16, 19

PAGE

Statutes and Regulations

Securities Act of 1933,

Section 11, 15 U.S.C. § 77k 17

Section 12, 15 U.S.C. § 77l 17

Securities Exchange Act of 1934,

Section 9, 15 U.S.C. § 78i 17

Section 10(b), 15 U.S.C. § 78j 3, 4, 13, 14, 15, 16, 17

Section 18, 15 U.S.C. § 78r(a) 16, 17

Rule 10b-5, 17 C.F.R. § 240.10b-5 .....3, 4, 5, 9, 13, 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

Nos. _____

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

CHARLES HEIT, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

BETTY VOLK, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

STANLEY R. GRANT, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, CARL M. LOEB, RHOADES & Co., a partnership, and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

HELEN HOWARD and WALTER V. TYMINSKI,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review judgments of the United States Court of Appeals entered in the above-entitled cases. The first two above-entitled

cases (hereinafter the "Heit" and "Volk" cases) were consolidated in the District Court, which entered a single judgment dismissing the consolidated complaint for legal insufficiency. The third above-entitled case (hereinafter the "Howard" case) was heard separately in the District Court and judgment was entered therein dismissing that complaint for legal insufficiency. The appeals taken from the two aforesaid judgments were consolidated and decided together in a single opinion rendered by the Court of Appeals on October 3, 1968. That opinion reversed the District Courts in view of the decision in *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), and remanded for further proceedings. Judge Moore dissented for the reasons set forth in his dissenting opinion in the *Texas Gulf Sulphur* case.

Opinions Below

The opinion of the Court of Appeals is not yet reported. It is printed as Appendix A hereto. The opinion of the District Court in the Heit and Volk cases is reported at 260 F.Supp. 598, and is printed as Appendix B hereto. The opinion of the District Court in the Howard case is reported at 262 F.Supp. 643, and is printed as Appendix C hereto.

Jurisdiction

The opinion of the Court of Appeals was rendered on October 3, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Question Presented

Plaintiffs-respondents Heit, Volk and Howard were each purchasers of securities of defendant Belock Instrument Corporation ("Belock").* Their complaints allege that Belock's assets and earnings were overstated in various reports and financial statements issued by Belock prior to plaintiffs' dates of purchase, and that defendants (Belock, its directors, accountant and investment banker) knew or should have known of the alleged overstatements. Nowhere does any complaint allege that any defendant made or caused these statements to be made in connection with, or for the purpose of, effectuating any sales or purchases of securities by himself or anyone associated with him.

These actions thus present the question whether or not the allegation of a false or erroneous corporate statement will, standing alone without any alleged securities activity by the defendant corporation or its officers, directors, or other insiders, provide a foundation for an action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, to a plaintiff who subsequently buys that company's stock in the open market.

The Court of Appeals, noting that it was "presented with significant questions involving civil liability under Section 10(b) . . .", held (Judge Moore dissenting) that in light of the principles enunciated in the *Texas Gulf Sulphur* case, a 10(b) cause of action did exist.

---

* On March 1, 1967 the name of petitioner Belock was changed to Applied Devices Corporation.

Statute and Rule Involved

Rule 10b-5 of the General Rules and Regulations promulgated by the Securities and Exchange Commission finds its statutory authorization in Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1964). The Section provides:

> "§78j. Manipulative and deceptive devices
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> • • •
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, promulgated under Section 10(b), in turn, provides:

> "§240.10b-5. Employment of manipulative and deceptive devices.
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> "(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

Statement of the Case

Each of these actions arose out of widely publicized misfortunes of defendant Belock Instrument Corporation, a New York manufacturer of precision instruments and components. On June 18, 1965 prominent stories appeared in The New York Times and The Wall Street Journal reporting that Belock had issued a statement the previous day announcing that its auditors had "confirmed the existence of irregularities" concerning the distribution of its costs in Government contracts. The company had previously confirmed that it was under investigation by the Department of Justice. The following Tuesday, June 22, 1965, the Securities and Exchange Commission suspended trading in Belock securities.

On August 18, 1965 the Grand Jury in the Eastern District of New York returned a 41-count indictment ('65 Cr. 388, E.D.N.Y.) against Walter V. Tyminski, president of Belock; Jack Silverstein, its vice president and comptroller; and Marvin Joseph Levy, its vice president of operations, charging them with the presentation of false claims to the United States Government for labor, overhead and general and administrative expenses with respect to certain Armed Forces contracts. These officers, who were named as defen-

dants in these actions (in addition to the defendants-petitioners here) had previously been suspended from their duties by Belock's Board of Directors, and new management had been instituted. Defendant Silverstein subsequently entered a plea of guilty to one count. Thereafter, Tyminski and Levy were tried by a jury which convicted Tyminski on several counts and acquitted Levy.

The Institution of These Actions

On June 25, 1965 a class action was commenced by plaintiff Heit, who had allegedly purchased Belock convertible debentures one week earlier on June 18, 1965, the very day that confirmation of Belock's previously reported difficulties with the Government had been prominently reported in The New York Times and The Wall Street Journal. (Parenthetically, it should be mentioned that while this might have seemed an inauspicious time to purchase Belock securities plaintiff Heit's purchase, nevertheless, proved to be a fortunate one. The Belock debentures which he then bought at 90 traded as high as 550 during 1968).

On July 14, 1965 another class action was commenced by plaintiff Helen Howard. She had allegedly purchased a single Belock convertible debenture on June 16, 1965 at 111.

Finally, on July 28, 1965 a third class action was commenced—this one by plaintiff Betty Volk, who had allegedly purchased 100 shares of Belock common stock on April 22, 1965 and another 100 shares on April 27, 1965, both purchases being made at 5½ per share. (Belock common traded at up to 26½ during 1968).

The jurisdiction of the District Court in these actions was based upon the Securities Act of 1933, as amended, 15 U.S.C. § 77a *et seq.*, and the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.*

In September 1965, prior to answering, the various defendants who had been served moved, pursuant to Rule 12(b)(6), Federal Rules of Civil Procedure, to dismiss each of the above complaints on the grounds that they failed to state a claim upon which relief could be granted.

On November 24, 1965 Judge Cooper rendered an opinion dismissing the Howard complaint on the ground that it was "fatally defective" in failing to "show the gravamen of defendants' activities to be any wise 'in connection with the purchase or sale of any security' as those words have been construed in their statutory setting."

On June 9, 1966 Judge (now Chief Judge) Sugarman rendered an opinion granting defendants' motions to dismiss the Heit and Volk consolidated amended complaint for failure "to state a federal claim upon which relief can be granted." Plaintiffs' subsequent motion for reargument was denied.

Thereafter, appeals were taken from the final judgments entered pursuant to the opinions of the District Court. Those appeals were consolidated and argued on November 10, 1967. Noting that it had deferred decision until after the filing of the opinion in *SEC* v. *Texas Gulf Sulphur, supra,* the Court of Appeals rendered a decision on October 3, 1968 reversing and remanding for further proceedings.

The Complaints

As indicated above, the decisions rendered below relate to two complaints, the Heit and Volk consolidated amended complaint and the Howard complaint.

Although, as indicated below, there are minor differences in phraseology between the two complaints, they are sub-

stantially the same. The gravamen of each complaint is found in its assertions of misstatements of assets and earnings in Belock's public financial reports. According to the complaints, the figures in these reports incorporated and reflected the false charges which had been attributed to the Government contracts in issue and, as a result, overstated Belock's true assets and earnings.

The Defendants

As alleged in the complaints, defendant Belock Instrument Corporation is a New York corporation having its principal plant and offices in College Point, Queens. It is engaged in the manufacture and sale of precision instruments and components with more than 90% of its current sales derived from U.S. Government contracts with the Armed Forces. Its common stock and Series A debentures are listed on the American Stock Exchange.

As additional defendants, the Heit complaint named Walter V. Tyminski, Marvin J. Levy and Jack Silverstein (the former Belock officers who were indicted), identifying them only as Belock officers or directors, and Edward H. Weitzen, Jack J. Fischer and Stanley R. Grant, each of whom is identified only as a Belock director.

The Howard action named as defendants the same above-listed individual defendants (except for defendant Levy, who is omitted), identifying each of them as both officers and directors of Belock, with the exception of the defendant Stanley R. Grant, who is alleged to be a director not holding any office in the Company. In addition, the firm of Lybrand, Ross Bros. & Montgomery ("Lybrand"), alleged to be Belock's auditors, and the partnership of Carl M. Loeb, Rhoades & Co., alleged to own

substantial amounts of Belock stock, are also named as defendants.

The Alleged Wrongdoing

In both complaints the wrongdoing alleged is essentially the same.

The Heit and Volk complaint alleges that on or about February 4, 1965 Belock, at the direction of the individual defendants, filed with the SEC and the American Stock Exchange its Annual Report for the fiscal year ending October 31, 1964. Copies are also alleged to have been distributed to security holders, the press and the investment community.

Paraphrasing only pa.t of the language of Rule 10b-5, Belock's Annual Report to stockholders is alleged to have contained "statements which were materially false and misleading" and "untrue statements of material facts" in that the Report is claimed to have "substantially overstated Belock's net assets and past and prospective income." The Heit complaint then goes on to allege that similar false statements were made in other Belock reports, documents, press releases and reports to stockholders for the quarters ending April 30, 1964, July 31, 1964, October 31, 1964, January 31, 1965 and for the half-year ending October 31, 1964.

The Howard complaint does not specify particular reports or documents, or a given time period, but alleges financial figures and statements pertaining to Belock's 1963 and 1964 fiscal years as being included in the reports disseminated. Belock's reports are said to have contained "statements concerning [Belock's] net profits and income

and * * * underlying balance sheets for the periods concerned [which] were materially overstated, false and inaccurate. . . ."

Each complaint goes on to give the same explanation for the alleged misstatements. According to the Heit complaint, they "were based in large part upon substantial overcharges to the United States Government in connection with the contracts between Belock and the Government." According to plaintiff Howard, Belock's financial statements "failed to reflect improper distribution of costs and substantial overcharges in certain Government contracts which had a materially adverse effect on the financial condition of Belock as well as on its published prior earnings reports. . . ."

In each complaint it is alleged that the release of the financial statements in issue "was intended to and did have the effect of artificially inflating the market prices of Belock's securities," or "served to raise or prevent the market prices from declining of the securities of Belock Instrument during the periods involved." Plaintiffs Heit and Volk allege reliance upon Belock's statements. Plaintiff Howard merely alleges that by reason of the Belock statements, Belock securities "have been sold to and bought by plaintiff and the public at artificially inflated prices. . . ."

The Basis for Defendants' Liability

The only basis for the liability alleged against the defendants in the Heit complaint is the statement that the individual defendants had "knowledge or notice" that the reports in question were "false, misleading and contained untrue statements of material facts."

The Howard complaint, while making somewhat more elaborate allegations, comes down to the same basis for liability. It charges that "Belock Instrument and the individual defendants caused or permitted such improper distribution of costs and overcharges or negligently failed to supervise the record and bookkeeping activities of Belock Instrument personnel." It is alleged that defendants "had or were charged with knowledge of the facts" and that "defendants owed plaintiff and all members of the class the duty of using reasonable care in the preparation and dissemination of the figures and forecasts • • • referred to."

Most significant is the total absence from either complaint of any allegation that any defendant made or caused the alleged misstatements to be made in connection with or for the purpose of effecting any sales of securities by him, by any persons associated with him, or by Belock.

Reasons for Granting the Writ

I.

These cases involve an issue of fundamental importance under the Federal Securities Acts.

The Problem Presented

Any significant misconduct (or unrecorded negligence) by a corporation, or its officers or agents, is bound to have some effect upon the corporation's financial and overall business picture. As a result, that corporation's financial statements and corporate reports will be inaccurate or incomplete to the extent that they fail to disclose or take account of that misconduct (or negligence).

If, for example, a corporate officer, unbeknownst to anyone, embezzles large sums from the corporate till, any balance sheet issued by the corporation prior to discovery of the embezzlement will contain a false statement of the corporation's assets.

Again, to pose another example, if a corporation has been guilty over a period of time of violations of the antitrust laws to the injury of third parties, any corporate report or financial prediction issued during that time by the corporation which fails to disclose that the company has potential treble-damage liabilities arising out of its antitrust violations may be said to omit to state a material fact concerning the corporation, or to misrepresent its actual liabilities or the company's financial condition.* If the corporation were held liable to anyone and everyone who purchased its securities during such period of time (which might have extended over many years) from third parties in the open market, the cost to one corporation could be astronomical and would, of course, bear no relationship to any securities transaction by the corporation.

The same will, of course, be true of any of the traditional varieties of unreported corporate misconduct or negligence underlying most stockholder derivative actions, such as insider dealings with the corporation, diversion of

---

* A dividing line between affirmative misrepresentation and omission will seldom, if ever, exist in situations where corporate financial statements fail to take alleged wrongdoing into account. The pleader can allege either a failure to disclose the wrongdoing, or misrepresentation in the company's financials because they fail to reflect the wrongdoing, or both. Here, for example, the Howard complaint alleges that Belock's financials "were materially overstated, false and inaccurate in that they failed to reflect improper distribution of costs and substantial overcharges in certain government contracts. . . ."

assets or misappropriations of corporate opportunities. Unless these are revealed in the company's reports, it may well be said that these reports contain untrue statements or omissions.

In each of the hypothetical situations described above, a purchaser or seller of the company's securities can plead, as in the case of Belock, that he sold or purchased in reliance upon the accuracy and completeness of the corporate reports, or at market prices which reflected the financial and business conditions of the company set forth in its reports.

The question presented here is whether or not the above kind of corporate misconduct, with its inevitable resultant effect upon the company's financial and other reports, can be deemed a "manipulative or deceptive device or contrivance" which is "use[d] or employ[ed], in connection with the purchase or sale of any security," within the language of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 when, as here:

> (a) neither the underlying misconduct nor the resultant misstatement or omission in the corporate report is alleged to have been effectuated with the intention, desire, or for the purpose, of inducing purchases or sales of the corporate securities, and plaintiffs themselves concede their inability to allege that defendants had any "motive or desire to inflate the market price" (Appellants' Brief in the Court of Appeals, pp. 33-34).
>
> (b) none of the defendants, nor anyone associated with any defendant, is alleged to have bought or sold any securities from or to anyone, or to have participated in any kind of securities transactions whatever.

Petitioners submit that to create a 10(b) cause of action premised upon such allegations (as the Court of Appeals did here) would effectively amend the statutory prohibition against any fraud "in connection with the purchase or sale of any security" so as to encompass any misconduct (or unrecorded negligence) in connection with any corporation whose securities are publicly held.

The Decision Below

The result reached here by the Court of Appeals was, as previously noted, based entirely upon the decision in *SEC* v. *Texas Gulf Sulphur Co., supra.* After reviewing the decisions rendered here by the District Courts, Judge Medina stated:

> "However, we must now reassess the holdings below in light of the principles enunciated in *SEC* v. *Texas Gulf Sulphur Co.*, Docket No. 30882 (2d Cir. *in banc* 1968) (Slip Sheet at 3587). Judge Waterman writing for the Court in *Texas Gulf Sulphur* construed the 'in connection with' requirement broadly and held that the clause was satisfied whenever a device was employed 'of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities,' *SEC* v. *Texas Gulf Sulphur Co.*, Slip Sheet at 3630. There is no necessity for contemporaneous trading in securities by insiders or by the corporation itself. 'Rule 10b-5 is violated whenever assertions are made * * * in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media * * * , if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes.' *SEC* v. *Texas Gulf Sulphur Co.*, Slip Sheet at 3634.

> "Applying this rule, and accepting at face value plaintiffs' well pleaded allegations, as we must on a motion to dismiss for failure to state a claim, we conclude that plaintiffs have met the requirements of the 'in connection with' clause."

The above-quoted holding in *Texas Gulf Sulphur* arose from that company's April 12, 1964 press release commenting upon rumors concerning its Timmons, Ontario mineral discovery. That press release both followed upon and preceded substantial insider trading in Texas Gulf Sulphur securities, although the company itself was not a purchaser or seller of securities.

Here, in contrast to *Texas Gulf Sulphur,* there is no charge whatever of any participation by the corporation or any insider in any transaction in Belock securities. The issue of whether or not a corporate misstatement or omission, in and of itself, gives rise to a 10(b) cause of action is clearly presented. Here, too, the question is presented in the context of an action at law for damages—not one solely for equitable or prophylactic relief, as in *Texas Gulf Sulphur.**

The Error Below

Judge Leonard Moore, who was a member of the panel here as well as in the *Texas Gulf Sulphur* case, has written a thorough dissent to the *Texas Gulf Sulphur* opinion including, in the portion dealing with the Texas Gulf Sulphur press release, many of the points and authorities advanced by the defendants in the appeals of these cases. In his dis-

---

* This Court has recognized that "It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193 (1963).

senting opinion here he incorporates by reference his *Texas Gulf Sulphur* dissent. Petitioners rely upon that portion of Judge Moore's *Texas Gulf Sulphur* opinion dealing with the press release and make no attempt to repeat the arguments and discussion set forth therein.

Suffice it to say, as Judge Moore points out, prior authorities under 10(b) had been founded upon some element of participation by a defendant in a securities transaction. Thus, *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), concerned a financial advisor who sold securities after its favorable recommendations had caused the market price to rise. In another leading case, *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951), the defendants, according to the complaint, had engaged in fraudulent conduct in connection with their sales of preferred stock. The Court held that other securities purchasers, *i.e.*, purchasers of common stock who had been injured by that fraud had standing to sue despite the absence of privity. Other prior cases are in the same vein.

The Federal Securities Act Would Be Effectively Recast

A direct result of the novel interpretation of Section 10(b) and Rule 10b-5 adopted here and in the *Texas Gulf Sulphur* case is that it completely undercuts the comprehensive scheme of regulation set forth in the Securities Acts. This is strikingly indicated by looking at Section 18 of the 1934 Act, 15 U.S.C. 78r(a). Plaintiffs here had sued under that Section as well as under 10(b) and the Court of Appeals, in Part II of its opinion, considered in detail whether or not a cause of action under Section 18 existed, remanding for further proceedings on that point.

Yet, there is no need or occasion for these plaintiffs or any other plaintiffs ever again to resort to Section 18—given the interpretation of 10(b) just adopted. If a corporation has issued any statement which can be alleged to be false or misleading, a 10(b) cause is made out, avoiding all of the substantive and procedural limitations of Section 18. The same would be true as to actions brought under Section 9 of the 1934 Act or Sections 11 or 12 of the 1933 Act—or any other sections of the various Securities Acts upon which private causes of action may be founded.

Thus, the practical result of the holding below would be to cast into discard all sections of the Securities Acts other than 10(b) and to make that Section the basis henceforth for all actions under the Federal securities laws—and, at the same time, to expand the Federal securities laws to cover virtually every sort of corporate misconduct.

Corporate Officers and Directors Would Be Subjected to Incalculable Claims for Damages

As previously noted, any significant corporate misconduct affects the corporate financial picture. With the modern, publicly-held corporation, which is constantly, and of necessity, publishing reports and financial statements, it is possible in virtually every case of corporate misconduct to point to some document issued by the corporation which was inaccurate, misleading or which contained omissions. To hold that this fact, standing alone, makes the misconduct one "in connection with the purchase or sale of any security" would turn every action for corporate misconduct into a federal securities fraud case.

In addition to providing a federal forum for virtually every case of corporate wrongdoing, the result reached

here would also subject corporate officers and directors to damage claims of incalculable amount brought by securities traders.

Thus, the vagaries of the securities market are such that revelation that the president of a corporation has stolen $1,000,000 from the corporation and fled to Brazil may send the market tumbling by tens of millions of dollars. To allow purchasers of stock to recover from the corporation or its officers, directors or accountants the amount the market has dropped—on the theory that the corporate reports failed to reflect the embezzlement due to the negligence or with the imputed knowledge of such persons—would result in judgments against such parties out of all rational proportion to whatever responsibility, if any, for the misdeeds or oversights may be theirs.

Indeed, if we take the case of some large publicly-held corporations, and pose hypothetical examples of wrongdoing for which their officers, directors and accountants might be held responsible under the theories of the complaints here, it is not hard to visualize situations where, as a result of some corporate wrongdoing not revealed in the corporate reports, market prices of securities might fall by billions of dollars, and purchasers of securities would—on Respondents' theories—be entitled to judgments in like amount against the directors, officers and accountants.

We have only to look at recent experience in the electrical equipment industry to find a situation where for many years certain conduct in violation of the antitrust laws was occurring which was undoubtedly not adverted to in corporate reports. Revelation of the extent of these violations and the consequences thereof to the corpora-

tions concerned had a most detrimental effect on the market prices for the securities of these companies. Under the Court of Appeals' theory, any person who purchased stock in these companies at a time when the antitrust violations were not known could bring a federal securities fraud case against the officers and directors, charging them with issuing false corporate reports which failed to take account of the antitrust violations and the corporations' potential liabilities flowing therefrom.

The fact that, so far as research can reveal, such actions as indicated in the above examples have not until now been even attempted demonstrates vividly the unique and unprecedented theory of law being adopted here and in the *Texas Gulf Sulphur* case.

CONCLUSION

The writ of certiorari should issue.

Respectfully submitted,

JOHN F. SONNETT
Attorney for Petitioners
Stanley R. Grant and Carl M. Loeb,
Rhoades & Co.

Of Counsel:

CAHILL, GORDON, SONNETT,
REINDEL & OHL
David R. Hyde
Immanuel Kohn

DEVEREUX MILBURN
Attorney for Petitioners
Edward H. Weitzen and
Jack J. Fischer

Of Counsel:

CARTER, LEDYARD & MILBURN
John F. X. Peloso

BORIS KOSTELANETZ
Attorney for Petitioner
Belock Instrument Corporation

Of Counsel:

KOSTELANETZ & RITHOLZ

WILBUR H. HECHT
Attorney for Petitioner
Lybrand, Ross Bros. & Montgomery

Of Counsel:

MENDES & MOUNT
John F. Byrne

January 2, 1969

APPENDIX "A"

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 162 and 163—September Term, 1967.

(Argued November 10, 1967 Decided October 3, 1968.)

Docket Nos. 30410 and 31157

CHARLES HAFT,

Plaintiff-Appellant,

—against—

EDWARD H. WEITZEN, [illegible], STANLEY R. GRANT, MARVIN J. LEVY, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Defendants-Appellees,

and

JACK SILVERSTEIN,

Defendant.

BETTY VOLK,

Plaintiff-Appellant,

—against—

EDWARD H. WEITZEN, WALTER V. TYZINSKI, STANLEY R. GRANT, MARVIN J. LEVY, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Defendants-Appellees,

and

JACK SILVERSTEIN,

Defendant.

APPENDICES

Dwight Mudgett
Attorney for Petitioners
Edward H. Weitzen and
Jack J. Fischer

Of Counsel:

Carter, Ledyard & Mudgett
John F. X. Peloso

Boris Kostelanetz
Attorney for Petitioner
Belock Instrument Corporation

Of Counsel:
Kostelanetz & Ritholz

William H. Hurlbut
Attorney for Petitioner
Lybrand, Ross Bros. & Montgomery

Of Counsel:

Mayer & Mount
John F. Byrne

January 2, 1969

APPENDICES

APPENDIX "A"

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 162 and 163—September Term, 1967.

(Argued November 10, 1967 Decided October 3, 1968.)

Docket Nos. 30410 and 31157

CHARLES HEIT,

Plaintiff-Appellant,

—against—

EDWARD H. WEITZEN, WALTER V. TYMINSKI, STANLEY R. GRANT, MARVIN J. LEVY, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Defendants-Appellees,

and

JACK SILVERSTEIN,

Defendant.

BETTY VOLK,

Plaintiff-Appellant,

—against—

EDWARD H. WEITZEN, WALTER V. TYMINSKI, STANLEY R. GRANT, MARVIN J. LEVY, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Defendants-Appellees,

and

JACK SILVERSTEIN,

Defendant.

HELEN HOWARD,

Plaintiff-Appellant,

—against—

STANLEY R. GRANT, WALTER V. TYMINSKI, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, CARL M. LOEB, RHOADES & Co., a partnership, and BELOCK INSTRUMENT CORPORATION,

Defendants-Appellees,

and

LAWRENCE J. LEVINE, JACK SILVERSTEIN, EDWARD H. WEITZEN, JOHN F. DONATO, JACK J. FISCHER, CHARLES WELTHY & HARRY AHRENS, as Executors of the Estate of HELEN NEUSCHAFER, deceased,

Defendants.

Before:

MEDINA, MOORE and HAYS,

Circuit Judges.

MEDINA, *Circuit Judge*:

On this appeal from two judgments dismissing plaintiffs' complaints, we are presented with significant questions involving civil liability under Sections 10(b) and 18(a) of the Securities Exchange Act of 1934. Because the principal questions involved on these appeals have been under consideration by the active judges of this Court sitting *in banc* we have deferred decision until after the filing of the opinions in *SEC* v. *Texas Gulf Sulphur Co.*, Docket No. 30882, on August 13, 1968.

There are three separate actions before us now, *Heit* v. *Weitzen, et al.*, and *Volk* v. *Weitzen, et al.*, originally con-

solidated by the District Court, and *Howard* v. *Grant, et al.*, consolidated on appeal by this Court with *Heit* and *Volk*. The various complaints involve essentially the same operative facts as they all are based on the fact that Belock Instrument Corporation allegedly failed to disclose that a substantial amount of its income for the fiscal year 1964 was derived from various overcharges on government contracts. Thus, the consolidated amended complaint in *Heit* and *Volk* alleges that Heit on June 18, 1965 purchased $5,000 principal face amount of Belock's 6% convertible subordinated debentures at a price of 90% of face amount in reliance on various "materially false, misleading and untrue statements of Belock's net assets and past and prospective income," contained in Belock's Annual Report, and press releases, as well as documents filed by the individual defendants with the SEC and the American Stock Exchange. Volk allegedly purchased 100 shares of Belock common stock on April 22, 1965 and another 100 shares on April 27, 1965 in reliance on these same false statements. Heit and Volk seek to represent both themselves and the entire class of persons who purchased either common stock or debentures between April 30, 1964 and June 21, 1965, and who have either sold or continue to hold these investments at a loss. It is further alleged that the dissemination by defendants of these false statements had the effect of artificially inflating the market price of Belock's common stock and debentures and that defendants had knowledge or notice of the falsity of the statements. In addition to Belock Corporation, the individual defendants served in *Heit* and *Volk* include Weitzen, Tyminski, Fischer, and Grant, all directors of Belock Corporation, and Levy who was a vice president of the corporation.

In the *Howard* complaint it is alleged that plaintiff Helen Howard purchased a 6% convertible subordinated Belock Corporation debenture on June 16, 1965 at an artificially inflated price. The price inflation was allegedly caused by the circulation and dissemination by the defendants "through press statements to the investment community * * * of statements as to the purported earnings and income of Belock Instrument and forecasts with respect thereto which in fact were gross overstatements." Howard seeks to represent the entire class composed of persons who purchased Belock stock or debentures in the open market and who were either misled by the published false material or by the artificially inflated market price. The defendants in *Howard* who were served include, in addition to Belock Corporation, Tyminski and Grant, Carl M. Loeb, Rhoades & Co., who is Belock's controlling shareholder, and Lybrand, Ross Bros. & Montgomery, Belock's auditors.

In *Howard,* Judge Cooper granted defendants' motion to dismiss for failure to state a claim upon which relief could be granted, primarily because the alleged fraud did not occur "in connection with the purchase or sale of any security" as required by Rule 10b-5. *Howard* v. *Levine,* 262 F. Supp. 643 (S. D. N. Y. 1965). Judge Sugarman, relying in part on Judge Cooper's opinion, similarly dismissed the Section 10b claims in *Heit* and *Volk* for failure to satisfy the "in connection with" clause. *Heit* v. *Weitzen,* 260 F. Supp. 598 (S. D. N. Y. 1966). Judge Sugarman also found that plaintiffs had failed to state a claim for relief under Section 18 of the 1934 Act since none of the reports upon which the claims were predicated were "filed" with the SEC as required by that Section. The motions to dismiss were granted without leave to replead. We also note that defen-

dants in all the actions have previously moved for summary judgment based on the fact that plaintiffs have suffered no damage since after the institution of these actions the price of both Belock's common stock and debentures has risen above the prices originally paid by plaintiffs. Neither of the judges below reached this question, nor do we.

I.

Rule 10b-5, 17 C. F. R. Section 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[1]

---

[1] The SEC in enacting Rule 10b-5 acted pursuant to the authority given it by virtue of Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. Section 78j(b). That section provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate com-

Each of the judges below referred to the fact that the basic fraudulent scheme alleged in the complaints was primarily directed toward the government "notwithstanding its possible incidental market impact." Thus, it was held that the concealment of the overcharges when the financial statements were released was for "the purpose of further defrauding the Government by not disclosing the original malfeasance and not for the purpose of perpetrating a 'misrepresentation or fraudulent practice usually associated with the sale or purchase of securities.'" *Heit* v. *Weitzen*, 260 F. Supp. 598, 602 (S. D. N. Y. 1966). Furthermore, as stated by Judge Cooper, since neither the corporate nor the individual defendants in the instant action were engaged in purchasing or selling Belock securities, he could see no basis for a finding that the alleged fraud occurred "in connection with the purchase or sale of any security."

However, we must now reassess the holdings below in light of the principles enunciated in *SEC* v. *Texas Gulf Sulphur Co.*, Docket No. 30882 (2d Circuit *in banc* 1968) (Slip Sheet at 3587). Judge Waterman writing for the Court in *Texas Gulf Sulphur* construed the "in connection with" requirement broadly and held that the clause was satisfied whenever a device was employed "of a sort that

---

merce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities," *SEC* v. *Texas Gulf Sulphur Co.*, Slip Sheet at 3630. There is no necessity for contemporaneous trading in securities by insiders or by the corporation itself. "Rule 10b-5 is violated whenever assertions are made * * * in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media * * * , if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes." *SEC* v. *Texas Gulf Sulphur Co.*, Slip Sheet at 3634.

Applying this rule, and accepting at face value plaintiffs' well pleaded allegations, as we must on a motion to dismiss for failure to state a claim, we conclude that plaintiffs have met the requirements of the "in connection with" clause. It is reasonable to assume that investors may very well rely on the material contained in false corporate financial statements which have been disseminated in the market place, and in so relying may subsequently purchase securities of the corporation. The "ulterior motive" present in the instant case—the concealment of the fraud from the government—is irrelevant, since the false information was circulated to a large segment of the investing public. It is impossible to isolate the particular "fraudulent" acts and consider them as directed toward the government alone.

As the "in connection with" clause has been satisfied, we must now deal with the question of the standard by which the conduct of the defendants is to be judged. Judge Waterman in the *Texas Gulf Sulphur* opinion held that proof of negligence was sufficient to sustain an action for

injunctive relief under Rule 10b-5(2), but at the same time found it not necessary to decide whether negligence absent a showing of bad faith would suffice in a private suit for damages. *SEC* v. *Texas Gulf Sulphur Co.*, Slip Sheet at 3637. However, no question of liability for damages was before the Court in *Texas Gulf Sulphur* and Judge Friendly, in a concurring opinion joined in part by other judges, intimated that the appropriate standard in a private damage action should embody a scienter requirement. *SEC* v. *Texas Gulf Sulphur Co., supra,* Slip Sheet at 3646-47. The question is troublesome. Compare *Weber* v. *C. M. P. Corp.*, 242 F. Supp. 321 (S. D. N. Y. 1965) with *Royal Air Properties, Inc.* v. *Smith,* 312 F. 2d 210 (9th Cir. 1962). See also III Loss, Securities Regulation at 1785.

There is no occasion for us to enter this thicket now as we pass only upon the legal sufficiency of the complaints to allege a claim for relief. This each of the complaints fairly does. The charge that defendants "knew or should have known" adequately alleges actual knowledge of the falsity of the statements, and, alternatively, negligence or lack of diligence in failing to ascertain the true facts. If some form of scienter test is to be applied, as Judge Friendly seems to suggest in his concurring opinion in *Texas Gulf Sulphur,* we think the alternative allegation of actual knowledge of falsity is amply sufficient as a matter of pleading. And this would seem to be so whether the scienter test ultimately applied be strict or liberal.[2] See

---

[2] The consolidated amended complaint in *Heit* and *Volk*:

Paragraph 7: The individual defendants had knowledge or notice that the reports, statements and documents referred to in paragraphs 5 and 6 above were false, misleading and con-

Fed. R. Civ. P. 8(e)(2); *Pettit* v. *American Stock Exchange*, 217 F. Supp. 21, 28-29 (S. D. N. Y. 1963); *Michael* v. *Clark Equipment Co. et al.*, 380 F. 2d 351, 352 (2d Cir. 1967).

Therefore, as far as the claims under Rule 10b-5 are concerned we reverse the judgments appealed from and hold that each of the complaints is sufficient to withstand a motion to dismiss for failure to state a claim for relief.

II.

Section 18(a) of the 1934 Act, 15 U. S. C. Section 78r(a) provides:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not know-

---

tained untrue statements of material facts, as hereinbefore alleged.

The complaint in *Howard*:

Paragraph 13: Belock Instrument and the individual defendants caused or permitted such improper distribution of costs and overcharges or negligently failed to supervise the record and bookkeeping activities of Belock Instrument personnel with respect to such government contracts.

Paragraph 14: The statements above alleged appeared on balance sheets and profit and loss statements referred to in paragraph 12 hereof which were examined or certified, or both, by defendant Lybrand, Ross, which knew or should have known that such balance sheets and profit and loss statements examined or certified by it were incorrect and false and misleading.

> ing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

Plaintiffs in *Heit* and *Volk* have contended that they relied on various documents which were "filed" within the meaning of Section 18. The documents in question are the "10K report" for the fiscal year ended October 31, 1964[3] and Belock's annual report for the same year, which was filed with the American Stock Exchange.

Judge Sugarman correctly ruled that the copies of the annual report submitted to the SEC were not "filed" docu-

---

[3] The "10K" report is a detailed document, similar to an annual report, which must be filed annually by all issuers of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 and by all registrants under the Securities Act of 1933 which are subject to Section 15d of the Securities Exchange Act. Rule 13a-1, 17 C. F. R. Section 240.13a-1; Rule 15d-1, 17 C. F. R. Section 240.15d-1. The SEC has issued specific instructions outlining the material which must be contained in the "10K" report. When the "10K" report is filed with the SEC additional supplemental information must also accompany the report. This supplemental information consists of any annual report for the registrant's last fiscal year and every form of proxy soliciting material sent to more than ten of the registrant's stockholders with respect to any annual or other meeting of stockholders. 17 C. F. R. Section 249.310. See also footnote 4 *infra* at p. 12a.

ments within the meaning of Section 18. Rule 14a-3(c), 17 C. F. R. Section 240.14a-3(c), of the Regulations under the Securities Exchange Act of 1934, as it read when the 1964 financial statements were issued on or about February 4, 1965 provided:

> Four copies of each annual report sent to security holders pursuant to this section shall be mailed to the Commission * * * . The annual report is not deemed to be "soliciting material" or to be "filed" with the Commission or subject to this regulation otherwise than as provided in this section, or to the liabilities of section 18 of the Act, except to the extent that the issuer specifically requests that it be treated as a part of the proxy soliciting material or incorporates it in the proxy statement by reference.

The above exemption provision, in addition to exempting the annual report filed with the SEC from the status of a "filed" document, also exempts the annual report filed with the American Stock Exchange from the coverage of Section 18. This result is required by the specific language of the second sentence of the above provision which contains several independent exemption clauses. Thus, the annual report is neither considered to be "filed with the Commission" nor subject to "the liabilities of section 18 of the Act." The latter phrase covers the alleged filing with the American Stock Exchange.

Although *Fischman* v. *Raytheon,* 188 F. 2d 783 (2d Cir. 1951) held that Section 18(a) applied to "documents" filed with a national securities exchange, the effect of the above regulation is to withdraw annual reports from the category of "filed" documents. The SEC has the power to prescribe rules that "may be necessary for the execution of the

functions vested in" it by the Securities Exchange Act, Section 23(a) Securities Exchange Act of 1934, 15 U. S. C. Section 78w(a), and in the performance of this duty the Commission may properly determine which filings are to be deemed "filings" for the purposes of Section 18.

Therefore, the only possible "filed" document remaining is the "10K report" which is submitted to the SEC.[4] We think it clear that the 10K report is a "filed" document within the meaning of Section 18.[5] See *Fischer* v. *Kletz,* 266 F. Supp. 180 (S. D. N. Y. 1967). The exemption provision contained in the SEC regulations relating to filing of the 10K report applies only to the copies of the annual report which accompany the 10K report and not the 10K report itself. Regulation 249.310 as it read when the Belock 10K report was allegedly filed provided:

> (i) Every registrant which files an annual report on this form [10K] shall furnish to the Commission for its information four copies of the following * * *

---

[4] SEC Regulations Section 249.310

> (b) General Instructions—(1) Rule as to use of Form 10-K. Form 10-K shall be used for annual reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, for which no other form is prescribed.

Section 13 of the Securities Exchange Act of 1934, 15 U. S. C. Section 78m

> (a) Every issuer of a security registered pursuant to Section 12 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security * * *
>
> (2) such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe.

[5] Defendants have conceded this point in their brief.

(a) any annual report to stockholders covering the registrant's last fiscal year;

* * * * *

(ii) The foregoing material shall not be deemed to be "filed" with the Commission or otherwise subject to the liabilities of Section 18 of the Act, except to the extent that the registrant specifically requests that it be treated as a part of its annual report on this form [10K] or incorporates it therein by reference.

The opinion of the District Court is unclear and we are unable to determine whether Judge Sugarman intended to hold that the 10K report was not a "filed" document. Appellees contend that Judge Sugarman ignored plaintiffs' claims based on form 10K simply because on oral argument appellants conceded that they could not allege or prove actual knowledge of and reliance upon any Belock 10K report. Appellants have denied making this concession. Reliance on the actual 10K report is an essential prerequisite for a Section 18 action and constructive reliance is not sufficient.[6] Therefore, although under the liberal pleading provisions of the Federal Rules of Civil Procedure, the *Heit* and *Volk* complaints might well be considered broad enough to cover the allegation that they

---

[6] This is made clear by comparing Section 18 with Section 11 of the Securities Act of 1933. Section 11 contains a provision enabling a plaintiff to establish reliance "without proof of the reading" of the particular document. See III Loss, Securities Regulation, p. 1752 (2d Ed. 1961). See also Comment, Civil Liability for Misstatements in Documents Filed Under Securities Act and Securities Exchange Act, 44 Yale L. J. 456, 460-61 (1935); Note, Accountants Liabilities for False and Misleading Financial Statements, 67 Colum. L. Rev. 1437, 1445 (1967).

relied on misrepresentations contained in 10K reports,[7] we believe it advisable to remand these cases to the District Court for a reconsideration of the question of leave to amend. Judge Sugarman may have relied on plaintiffs' alleged concession or he may have thought that the complaint was not broad enough to cover an allegation of reliance on a 10K report. On the other hand, he may have incorrectly assumed that a 10K report could not form the basis for a Section 18 action. Thus the interests of justice would seem to require a clear appraisal of the pros and cons.

Finally, although the complaint in *Howard* contains no Section 18 claim for relief, it is stated in appellants' brief that such allegations will be added to the *Howard* complaint "if leave to amend is granted." We leave this for the consideration of the District Court if, as and when such an application for leave to amend is addressed to that Court.

---

[7] *Heit-Volk* consolidated amended complaint.

Paragraph 5(a): On or about February 4, 1965, Belock, at the direction of the individual defendants, caused to be filed with the Securities and Exchange Commission ("SEC"), pursuant to the provisions of the Securities Exchange Act of 1934 and the General Rules and Regulations promulgated thereunder, and with the American Stock Exchange, its Annual Report for the fiscal year ended October 31, 1964.

Paragraph 6: Similar materially false, misleading and untrue statements of Belock's net assets and past and prospective income were contained in reports and other documents filed by Belock at the direction of the individual defendants with the SEC and the American Stock Exchange, as well as in press releases and reports to stockholders for the quarters ending April 30, 1964, July 31, 1964, October 31, 1964, January 31, 1965, and for the half-year ending October 31, 1964, issued by Belock at the direction of the individual defendants.

Paragraph 11(a): Plaintiffs purchased and retained Belock's securities and reliance on the truth of the statements and representations herein alleged.

III.

The District Court did not rule on defendants' motions for summary judgment. We believe it would be inappropriate at this early stage in the proceedings to deal with the issue of damages raised by these motions. We agree with the SEC that questions relating to damages should be postponed until after the facts have been fully developed at the trial.[8]

We wish to express our thanks to the SEC for submitting an *amicus curiae* brief at our request in this case.

Reversed and remanded for further proceedings consistent with this opinion.

MOORE, *Circuit Judge* (dissenting):

For the reasons set forth in my dissenting opinion in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co., et al.*, —— F. 2d —— (Slip Opinion, pp. 3676-3690), I would hold that the "in connection with the purchase or sale of any security" requirement of Rule 10b-5 has not been met in the complaints dismissed below. Therefore, I would affirm the decisions of Judges Sugarman and Cooper. Apparently, the propriety of these suits as appro-

---

[8] SEC *Amicus Curiae* Brief at p. 32.

> [The determination of this issue] should properly await the trial of the case, which will provide a complete record as to exactly what the defendants did, why they did it and how this affected the plaintiffs. We believe the Court will then be in a better position to examine and resolve questions with respect to the appropriate remedy, giving consideration to how a damage award against the issuer would affect the issuer and all of its stockholders, including those who neither bought nor sold. In so doing the Court will be able to utilize its traditional flexibility with respect to remedies, avoiding, on the one hand, Draconian relief and, on the other hand, an opportunity for violators to profit from their wrongdoing.

priate class actions has not been presently challenged and is not before us. In any event, even if proper, resolution of any and all issues relating thereto would be for the trial. The Heit and Volk consolidated amended complaint alleges that plaintiff Heit "brings this action on his own behalf and on behalf of all other persons who purchased Belock's debentures between April 30, 1964 and June 21, 1965, and who have either sold or continue to hold such debentures at a loss." The allegation as to Volk is identical except that it relates to common stock. Obviously, such a class, which plaintiffs claim to champion, would be wholly unrelated to any of the facts as pleaded. Belock was engaged principally in engineering and manufacturing military electronic equipment. The price range of Belock's 6% convertible debentures in 1964 was 178 high and 97½ low and in the first six months of 1965, 149 high and 75 low; for the common stock the range was 1964 high 5⅜, low 3⅝, and for the first six months of 1965, 5⅞ high, 2⅝ low. The causes for the wide fluctuations of the thousands of listed securities would be legion even if ascertainable and cover events from the national and international to ever-changing local situations in specific companies. A class for purposes of a lawsuit could scarcely consist of all persons who bought stock on one of the national exchanges and subsequently sold it at a loss. To be sure, plaintiffs qualify this claim by alleging that "The other members of the stock class and the debenture class purchased and retained Belock's securities in reliance on the truth of the statements and representations herein alleged." Cons. Am'd Compl. ¶11(b). Thus, limited to "reliance," possibly a "class" is stated. As previously stated, this determination, together with damages, if any, must await a trial. The same infirmities as to "class" exist in my opinion in the Howard complaint to an even greater extent because the limitation is less specific.

APPENDIX "B"

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF NEW YORK

No. 65 Civ. 1942

June 10, 1966

CHARLES HEIT,

Plaintiff,

—against—

EDWARD H. WEITZEN, WALTER V. TYMINSKI, JACK SILVERSTEIN, STANLEY R. GRANT, MARVIN J. LEVY, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Defendants.

BETTY VOLK,

Plaintiff,

—against—

EDWARD H. WEITZEN, WALTER V. TYMINSKI, JACK SILVERSTEIN, STANLEY R. GRANT, MARVIN J. LEVY, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Defendants.

SUGARMAN, District Judge.

Charles Heit (Heit) as plaintiff in 65 Civil 1942 and Betty Volk (Volk) as plaintiff in 65 Civil 2303 each commenced an action against defendants Weitzen, Tyminski, Silver-

stein, Grant, Levy, Fischer and Belock Instrument Corporation (Belock), seeking damages alleged to have been sustained by each plaintiff in purchasing securities of defendant Belock. In due course the actions were consolidated and a "consolidated amended complaint" (the complaint) was filed on November 19, 1965.

The complaint bases jurisdiction on § 22(a)[1] of the Securities Act of 1933 (the 1933 Act), § 27[2] of the Securities Exchange Act of 1934 (the 1934 Act) "and the principles of pendent jurisdiction", as an action arising under §§ 12(2)[3] and 17(a)[4] of the 1933 Act and §§ 9(e),[5] 10(b)[6] and 18(a)[7] of the 1934 Act, "the General Rules and Regulations promulgated under both statutes; and under common-law principles".

The facts alleged are that plaintiff Volk and plaintiff Heit is each "a security holder of defendant Belock", Volk having purchased 100 shares of Belock's common stock on April 22, 1965 and another 100 shares of Belock's common stock on April 27, 1965, all at $5½ per share and Heit having purchased $5,000 face amount of Belock's 6% convertible subordinated debentures on June 18, 1965 at a price of 90% of the face amount.

Volk, although as aforesaid, she alleges that she acquired her stock on April 22 and April 27, 1965, sues on her own

---

[1] 15 U.S.C. § 77v.

[2] 15 U.S.C. § 78aa.

[3] 15 U.S.C. § 77*l*.

[4] 15 U.S.C. § 77q.

[5] 15 U.S.C. § 78i(e).

[6] 15 U.S.C. § 78j(b).

[7] 15 U.S.C. § 78r(a).

behalf and on behalf of all other persons who purchased Belock's common stock between April 30, 1964 and June 21, 1965 and "who have either sold or continue to hold such stock at a loss" (the stock class).

Heit, although as aforesaid, he alleges that he acquired his debentures on June 18, 1965, sues on his own behalf and on behalf of all other persons who purchased Belock's debentures between April 30, 1964 and June 21, 1965 and "who have either sold or continue to hold such debentures at a loss" (the debenture class).

It is further alleged that defendants Weitzen, Tyminski, Fischer, Grant and Silverstein constituted, during the times mentioned, all or a majority of Belock's board of directors and that at all such times defendant Tyminski was Belock's president, defendant Silverstein was Belock's vice president and controller and defendant Fischer was Belock's secretary, and that Tyminski's and Silverstein's tenure terminated on August 18, 1965 by their removal as officers of Belock at which time defendant Levy was also removed as a vice president of Belock to which office he had been elected in the summer or fall of 1964.

The complaint then avers that defendant Belock, which manufactures and sells precision and other instruments and components, is a New York corporation, with its principal office in Queens County, New York; that at all the times mentioned its common stock was and now is listed on the American Stock Exchange (ASE); that since February 11, 1963 its debentures (Series A) were and now are listed on said Exchange and from January 23, 1963 to June 21, 1965 its debentures (Series B) were traded on the over-the-counter market.

The complaint then charges that on or about February 4, 1965 defendant Belock, at the direction of the individual

defendants, caused to be filed with the Securities and Exchange Commission (SEC) pursuant to the provisions of the 1934 Act and the General Rules and Regulations promulgated thereunder and with the ASE its annual report for the fiscal year ending October 31, 1964 and thereafter caused copies of said annual report to be sent to its security holders, the press, brokers and dealers, research organizations and financial institutions.

It is further charged by plaintiffs that the said annual report

> "contained statements which were materially false and misleading and contained untrue statements of material facts in that they substantially overstated Belock's net assets and past and prospective income"

because *inter alia*

> "such statements of assets and income were based in large part upon the inclusion therein of earnings, income and assets resulting from substantial overcharges to the United States Government in connection with contracts between Belock and the Government."

It is also alleged that similar materially false, misleading and untrue statements of Belock's net assets and past and prospective income were contained in reports and other documents filed by Belock at the direction of the individual defendants with the SEC and the ASE for the quarters ending April 30, July 31 and October 31, 1964, for the half year ending October 31, 1964 and for the quarter ending January 31, 1965 and that these were released to the press and to the stockholders.

The complaint further charges that the individual defendants "had knowledge or notice" that the said reports,

statements and documents "were false, misleading and contained untrue statements of material facts" and that the dissemination thereof was "intended to, and did, have the effect of artificially inflating the market prices of Belock's" securities.

After alleging that the offending data were distributed in interstate commerce, etc., the complaint charges that

> "As a result of the defendants' acts * * * Belock's common stock and debentures were sold to and bought by plaintiffs and the other members of the stock class and the debenture class at artificially inflated prices substantially in excess of their value, and such value has since been further reduced on account of such acts."

Claiming that they and the other members of the two classes purchased and retained Belock's securities in reliance on the truth of the statements and representations alleged, plaintiffs aver that they thereby "sustained substantial damages".

Asserting that plaintiffs and the other members of the two classes did not, and could not by the exercise of reasonable diligence, discover the facts alleged more than a few days prior to the institution of "these actions" and the reasons for the class actions, the plaintiffs then demand judgment for damages and the expenses of the litigation.

The sufficiency of the complaint is now challenged by four motions:—One, by defendant Tyminski, pursuant to F.R. Civ.P. 12(b) (6) to dismiss the complaint for failure to state a claim upon which relief can be granted and the remaining three by defendant Grant and defendant Belock separately and defendants Weitzen and Fischer jointly, seeking relief similar to that sought by Tyminski but in

addition and alternatively, under F.R.Civ.P. 56, summary judgments in favor of said defendants upon the grounds that since plaintiffs purchased their securities at the prices stated, Belock's common stock and debentures have sold at prices in excess of that paid by each plaintiff and that plaintiffs have therefore suffered no damage.

In their memorandum in opposition to the four motions, plaintiffs make no mention of their allegations in their complaint that their suit is based on §§ 12(2) and 17(a) of the 1933 Act and § 9(e) of the 1934 Act, and, despite the arguments of defendants *inter alia* in their memoranda that those sections of the acts supply no basis for this suit, plaintiffs address themselves solely to their right to sue under §§ 10(b) and 18(a) of the 1934 Act. Since the compelling reasons stated by defendants in challenging plaintiffs' right to sue under §§ 12(2) and 17(a) of the 1933 Act and § 9(e) of the 1934 Act, are ignored by plaintiffs, it is assumed that plaintiffs have abandoned those claims.

It should be remembered that we are not dealing here with the enormity of the fraud alleged but simply with the question of whether plaintiffs' complaint states a claim for which redress may be had in a federal court under the federal statutes and rules relied upon.

The 1934 Act provides in § 10(b):

> "REGULATION OF THE USE OF MANIPULATIVE AND DECEPTIVE DEVICES
>
> Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> • • • • • —•

(b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b–5[8] promulgated by the SEC pursuant to § 10(b) supra reads:

"Rule 10b–5. Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

---

[8] 17 CFR § 240.10b–5.

The complaint alleges as operative facts simply that certain of Belock's quarterly, semi-annual and annual reports filed with the SEC and the ASE and otherwise disseminated overstated Belock's net assets and past and prospective income because they omitted disclosure that these included the product of substantial recoverable overcharges by Belock to the Government on contracts between them.

Accepting this statement as true for the purposes of this motion under F.R.Civ.P. 12(b) (6), the defendants did therefore at least "omit to state a material fact necessary in order to make the statements made * * * not misleading" which Rule 10b–5(b) proscribes. However, to be unlawful and actionable, the forbidden act or omission must, under both the statute and the rule, occur "in connection with the purchase or sale of any security".

While the complaint charges that the individual defendants "had knowledge or notice" of the misleading reports, which "artificially inflated the market prices of Belock's common stock and debentures" causing plaintiffs and the members of the two classes, relying on the statements, to purchase Belock's securities "at artificially inflated prices substantially in excess of their value" it is devoid of the statement of any facts that the fraud complained of was perpetrated by the defendants "in connection with any purchase or sale" of Belock's stock or debentures.

The fraud against the Government in overcharging it on the contract having been already accomplished, the concealment thereof from the filed statements was for the purpose of further defrauding the Government by not disclosing the original malfeasance and not for the purpose of perpetrating a "misrepresentation or fraudulent practice usually associated with the sale or purchase of securi-

ties". Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952), cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952).

On the same operative facts as are presented here, Judge Cooper, in Howard v. Levine, D.C., 262 F.Supp. 643, dismissed the complaint in that action upon the grounds that

> "The instant complaint is fatally defective for the allegations here do not show the gravamen of defendants' activities to be any wise 'in connection with the purchase or sale of any security' as those words have been construed in their statutory setting. Whatever fraud is alleged here (it is in bare skeletal form) is directed against the government, notwithstanding its possible incidental market impact. Furthermore, defendants or persons associated with them did not participate in the security transactions involved. Joseph v. Farnsworth Radio & Television Corp., 99 F.Supp. 701 (S.D.N.Y.1951), aff'd per curiam, 198 F.2d 883 (2d Cir. 1952). Cf. Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); H. L. Green Co., Inc. v. Childree, 185 F.Supp. 95 (S.D.N.Y.1960). * * * "

Plaintiffs' attempt to distinguish the *Howard* complaint from this one because the former merely alleged circulation and dissemination of the offensive statements whereas the latter also alleges filing thereof with the SEC and the ASE, in so far as the § 10(b) and Rule 10b–5 aspect of the case are concerned, is an unimpressive and unpersuasive distinction without a difference.

The *Howard* complaint, *inter alia*, disclosed:

> "The statements * * * were examined or certified, or both, by * * * Lybrand, Ross, [defendant-accountant

firm] which knew or should have known that such * * * were incorrect and false and misleading.

* * * The publication and dissemination of the material alleged * * * served to raise or prevent the market prices from declining of the securities of Belock * * * as the defendants well knew and intended and the defendants [named] benefited therefrom.

* * * The * * * statements * * * were circulated * * * to influence and manipulate the prices of securities of Belock * * * and constituted the employment * * * of a device, scheme or artifice to defraud * * * which operated as a fraud or deceit upon plaintiff and all others similarly situated.

* * * The defendants had or were charged with knowledge of the facts alleged * * * *"*

As to those allegations in the *Howard* complaint Judge Cooper held:

"In addition, the allegations of fraud are legally insufficient even under a liberal construction of the pleadings afforded to plaintiffs on a motion to dismiss. O'Neill v. Maytag, 230 F.Supp. 235, 239 (S.D.N.Y.) aff'd., 339 F.2d 764 (2d Cir. 1964); Weber v. C.M.P. Corp., 242 F.Supp. 321 (S.D.N.Y.1965). * * * *"*

In the complaint here under consideration no more is alleged for all that is stated is that

"The individual defendants had knowledge or notice that the reports, statements and documents * * * were false, misleading and contained untrue statements of material facts * * * [and that] The dissemination of the statements * * * was intended to, and did, have

the effect of artificially inflating the market prices of Belock's common stock and debentures."

The complaint herein, to the extent that it purports to state a claim for relief under § 10(b) of the 1934 Act and Rule 10b–5 of the SEC is vulnerable.

As aforesaid, the complaint also states that the claims asserted therein arise under § 18(a) of the 1934 Act. In this regard it differs from the complaint in the *Howard* case which made no such claim.

Section 18(a) of the 1934 Act provides:

"LIABILITY FOR MISLEADING STATEMENTS

Sec. 18. (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an

undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant."

It is obvious that for the plaintiffs to prevail under this section it must appear that the reports which they claim failed to disclose the fraud against the Government were such as were "filed pursuant to this title or any rule or regulation thereunder". Regardless of what meaning the verb "filed" may have in any other context, cf. 36A C.J.S. p. 395, it has a very limited meaning under § 18(a) of the 1934 Act with respect to reports such as those here involved.

The only pertinent reports required by the statute are those mandated by § 13(a) (2)* of the 1934 Act, which provides:

"Sec. 13. Periodical and other reports

(a) Every issuer of a security registered pursuant to section 12 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security—

* * * * * *

(2) such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe."

---

* 15 U.S.C. § 78m.

Under § 13(a) (2) of the 1934 Act the SEC was vested with the power to require that annual reports be certified by independent public accountants and to require the filing of quarterly reports. It has exercised those powers with respect to companies such as defendant Belock only to the extent of requiring annual and semi-annual reports.[10] The annual reports are those filed on Form 10–K and the semi-annual reports are those filed on Form 9–K. The Commission's rules governing these reports in pertinent part are as follows:

(As to annual reports—Form 10–K):
"17 CFR

Annual Reports

§ 240.13a–1 Requirement of annual reports.

Every issuer having securities listed and registered on a national securities exchange shall file an annual report for each fiscal year after the last full fiscal year for which financial statements were filed in its application for registration. • • •

§ 249.310 Form 10–K, annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934.

• • • • • •

(b) General instructions—(1) *Rule as to use of Form 10–K.* Form 10–K shall be used for annual reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, for which no other form is prescribed.

• • • • • •

[10] Quarterly reports are required to be filed by investment companies, 17 CFR § 240.13a–12, and by certain real estate companies, 17 CFR § 240.13a–15.

(o) *Annual reports and proxy material sent to stockholders.* (i) Every registrant which files an annual report on this form shall furnish to the Commission for its information four copies of the following • • •

(a) Any annual report to stockholders covering the registrant's last fiscal year • • •

Such material shall be mailed to the Commission not later than the date on which it is first sent to stockholders • • •

(ii) The foregoing material shall not be deemed to be 'filed' with the Commission or otherwise subject to the liabilities of section 18 of the Act • • • "

(As to semi-annual reports—Form 9–K):

"17 CFR § 240.13a–13 Semi-annual reports on Form 9–K.

(a) Every issuer of a security registered on a national securities exchange which is required to file annual reports on Form 10–K • • • shall file a semi-annual report on Form 9–K • • •

• • • • • •

(d) Notwithstanding the foregoing paragraphs of this section, reports pursuant to this section on Form 9–K shall not be deemed to be 'filed' for the purpose of section 18 of the act or otherwise subject to the liabilities of that section • • • "

From the foregoing rules it is quite clear that none of the reports upon which the plaintiffs' claims are predicated were "filed" with the Commission as required by § 18(a) of the 1934 Act.

It follows, therefore, that the complaint herein to the extent that it purports to state a claim for relief under § 18(a) of the 1934 Act is also vulnerable.

Thus, since the complaint fails to state a federal claim upon which relief can be granted, there is no pendent jurisdiction of the state claims surviving and as Judge Cooper observed in the *Howard* case

> "• • • there being no diversity jurisdiction alleged, any causes of action recognized under state law as set forth in the complaint should also be dismissed. Ruckle v. Roto American Corp., 339 F.2d 24, 27 (2d Cir. 1964) • • •"

In the light of the conclusion that the defendants' motions to dismiss the complaint must prevail, the additional and alternative motions of some of the defendants for summary judgment are not passed upon.

The motions by defendants Tyminski, Grant and Belock severally and of the defendants Weitzen and Fischer jointly to dismiss the complaint herein pursuant to F.R.Civ.P. 12(b) (6) are granted without leave to plead anew.

It is so ordered. No further order is necessary.

APPENDIX "C"

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF NEW YORK

No. 65 Civ. 2148

November 24, 1965

HELEN HOWARD,

Plaintiff,

—against—

LAWRENCE J. LEVINE, JACK SILVERSTEIN, STANLEY R. GRANT, WALTER V. TYMINSKI, EDWARD H. WEITZEN, JOHN F. DONATO, JACK J. FISCHER, CARL M. LOEB, RHOADES & Co., a partnership, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, and JACK J. FISCHER, CHARLES WELTHY and HARRY AHRENS, as Executors of the Estate of HELEN NEUSCHAFER, DECEASED and BELOCK INSTRUMENT CORPORATION,

Defendants.

COOPER, District Judge.

These are motions to dismiss a complaint under Rule 12(b) (6), F.R.Civ.P. for failure to state a claim upon which relief can be granted.

The complaint is apparently predicated on Section 10(b) of the Securities Act of 1934, 15 U.S.C. § 78j(b) and Rule 10B–5, 17 C.F.R. 240.10b–5, the jurisdiction of the Court

being invoked under 15 U.S.C. § 78aa.[1] In essence, the complaint alleges that Loeb, Rhoades & Co., Belock Instrument and the individual defendants have caused to be circulated and disseminated to the public-at-large financial statements which were gross overstatements because they failed to reflect improper distribution of costs and overcharges in certain government contracts; this dissemination served to raise the market price of Belock Instrument, and the defendants "benefited therefrom."

Rule 10B–5 requires that the alleged fraud or deceit be "in connection with the purchase or sale of any security." As the Court said in Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952), "that section [10b] was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs * * *." O'Neill v. Maytag, 339 F.2d 764, 768 (2d Cir. 1964).

The instant complaint is fatally defective for the allegations here do not show the gravamen of defendants' activities to be any wise "in connection with the purchase or sale of any security" as those words have been construed in their statutory setting. Whatever fraud is alleged here (it is in bare skeletal form) is directed against the government, notwithstanding its possible incidental market impact. Furthermore, defendants or persons associated with them did not participate in the security transactions involved. Joseph v. Farnsworth Radio & Television Corp., 99 F.Supp. 701 (S.D.N.Y.1951), aff'd per curiam, 198 F.2d

[1] In oral argument and their briefs, the parties do not rely upon the Securities Act of 1933, as amended. 15 U.S.C. § 77a et seq., (see ¶ 1 of the complaint). As we see it, consideration of that Act does not alter the conclusion here reached.

883 (2d Cir. 1952). Cf. Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); H. L. Green Co., Inc. v. Childree, 185 F.Supp. 95 (S.D.N.Y.1960). In addition, the allegations of fraud are legally insufficient even under a liberal construction of the pleadings afforded to plaintiffs on a motion to dismiss.[2] O'Neill v. Maytag, 230 F.Supp. 235, 239 (S.D.N.Y.) aff'd, 339 F.2d 764 (2d Cir. 1964); Weber v. C. M. P. Corp., 242 F.Supp. 321 (S.D.N.Y.1965). Finally, there being no diversity jurisdiction alleged, any causes of action recognized under state law as set forth in the complaint should also be dismissed. Ruckle v. Roto American Corp., 339 F.2d 24, 27 (2d Cir. 1964).

Accordingly, the motions to dismiss are granted. We see no basis for permission to replead.

This shall be considered an order; settlement thereof is unnecessary.

So ordered.

---

[2] In view of this analysis, the policy arguments and views advanced by plaintiffs at pages 8-9 and 19-20 of their Memorandum filed in Court on November 3, 1965 cannot provide a basis for sustaining their complaint.

SUPREME COURT, U. S.

FILED

JAN 21 1969

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 894

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

CHARLES HEIT, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

BETTY VOLK, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

STANLEY R. GRANT, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, CARL M. LOEB, RHOADES & Co., a partnership, and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

HELEN HOWARD and WALTER V. TYMINSKI,

Respondents.

BRIEF FOR RESPONDENTS WALTER V. TYMINSKI and MARVIN J. LEVY

Of Counsel:

BATTLE, FOWLER, STOKES & KHEEL
280 Park Avenue
New York, New York 10017

SAMUEL R. PIERCE, JR.
280 Park Avenue
New York, New York 10017
Attorney for Respondent Walter V. Tyminski

HYMAN BRAVIN
6 East 45th Street
New York, New York 10017
Attorney for Respondent Marvin J. Levy

In the

Supreme Court of the United States

October Term, 1968

No. 894

Edward H. Weitzen, Stanley R. Grant, Jack J. Fischer and Belock Instrument Corporation,

Petitioners,

—against—

Charles Heit, Walter V. Tyminski and Marvin J. Levy,

Respondents.

Edward H. Weitzen, Stanley R. Grant, Jack J. Fischer and Belock Instrument Corporation,

Petitioners,

—against—

Betty Volk, Walter V. Tyminski and Marvin J. Levy,

Respondents.

Stanley R. Grant, Lybrand, Ross Bros. & Montgomery, a partnership, Carl M. Loeb, Rhoades & Co., a partnership, and Belock Instrument Corporation,

Petitioners,

—against—

Helen Howard and Walter V. Tyminski,

Respondents.

BRIEF FOR RESPONDENTS WALTER V. TYMINSKI and MARVIN J. LEVY

Walter V. Tyminski and Marvin J. Levy, named as Respondents in the above entitled case, have each been served with a petition and brief for writ of certiorari by the above named Petitioners. Said Respondents support the position of the Petitioners and, therefore, pray that a writ of certiorari issue to review the judgments of the United States Court of Appeals.

Respectfully submitted,

SAMUEL R. PIERCE, JR.
Attorney for Respondent
Walter V. Tyminski

Of Counsel:

BATTLE, FOWLER, STOKES
& KHEEL

HYMAN BRAVIN
Attorney for Respondent
Marvin J. Levy

SUPREME COURT, U. S.

FILED

FEB 8 1969

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 894

EDWARD H. WEITZEN et al.,

Petitioners,

—against—

CHARLES HEIT et al.,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

WILLIAM E. HAUDEK,
Attorney for Respondents Charles Heit, Betty Volk and Helen Howard,
295 Madison Avenue,
New York, N. Y. 10017.

Of Counsel:

POMERANTZ LEVY HAUDEK & BLOCK,
295 Madison Avenue,
New York, N. Y. 10017

ARTHUR W. LICHTENSTEIN,
295 Madison Avenue,
New York, N. Y. 10017

LAWRENCE MILBERG,
2 Park Avenue
New York, N. Y. 10016

32 CASE PRESS INC., 121 HUDSON ST., N.Y.—OREGON 5-4540

TABLE OF CONTENTS

	PAGE
Opinions Below	1
Statement of the Case	1
The Question Presented	3
REASONS FOR DENYING THE WRIT	
I—The question raised by the petition is insubstantial and has recently been answered by this Court	4
1. Rule 10b-5 does not require "privity"	4
2. Rule 10b-5 does not require a securities transaction by the wrongdoer	4
3. A recent decision of this Court in effect rejects petitioners' position	7
II—Petitioners are not relieved from 10b-5 liability because they also committed a fraud upon the Government	9
III—Liability under Rule 10b-5 does not depend on a fraudulent purpose or motive on the part of the wrongdoer	11
CONCLUSION	12

Authorities Cited

Table of Cases

	PAGE
Agnew v. United States, 165 U.S. 36 (1897)	11
Bredehoeft v. Cornell, 260 F. Supp. 557 (D. Ore. 1966)	4
Brennan v. Midwestern United L. Ins. Co., 259 F. Supp. 6.3 (N.D. Ind. 1966)	4
Claflin v. Commonwealth Ins. Co., 110 U.S. 81 (1884)	11
Conley v. Gibson, 355 U.S. 41 (1957)	10
Cooper v. North Jersey Trust Co., 226 F. Supp. 972 (SDNY 1964)	7
Donovan, Inc. v. Taylor, 136 F. Supp. 552 (N.D. Cal. 1955)	4
Fischer v. Kletz, 266 F. Supp. 180 (SDNY 1967) ...	4, 7
Freed v. Szabo Food Service, '61-'64 CCH Fed. Sec. L. Rep. ¶91, 317, at pp. 94, 363-4 to 94, 363-5 (N.D. Ill. 1964)	4
Glickman v. Schweickart & Co., 242 F. Supp. 670 (SDNY 1965)	7
Heit v. Weitzen, 260 F. Supp. 598 (SDNY 1966)	1
Heit v. Weitzen, 402 F. 2d 909 (2 Cir. 1968)	1
Howard v. Levine, 262 F. Supp. 643 (SDNY 1965) ..	1
Kohler v. Kohler Co., 319 F. 2d 634 (7 Cir. 1963) ..	12
Lorenz v. Watson, 258 F. Supp. 724 (E.D. Pa. 1966)	12
Miller v. Bargain City, 229 F. Supp. 33 (E.D. Pa. 1964)	4, 7
Mutual Shares Corp. v. Genesco, Inc., 384 F. 2d 540 (2 Cir. 1967)	4
Myzel v. Fields, 387 F. 2d 718 (8 Cir. 1967), cert. den. 390 U.S. 951 (1968)	12
New Park Mining Co. v. Cranmer, 225 F. Supp. 261 (SDNY 1963)	4
Royal Air Properties, Inc. v. Smith, 312 F. 2d 210 (9 Cir. 1962)	12

PAGE

SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) 6
SEC v. Howey Co., 328 U.S. 293 (1946) 7
SEC v. National Securities, Inc., U.S. , 37 U.S. Law Week 4101 (Jan. 27, 1969) 7, 8, 9
SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833 (2 Cir. 1968) 7, 8
Stevens v. Vowell, 343 F. 2d 374 (10 Cir. 1965) 12
Stockwell v. Reynolds & Co., 252 F. Supp. 215 (SDNY 1965) .....
Tcherepnin v. Knight, 389 U.S. 332 (1967) 6
Texas Continental L. Ins. Co. v. Dunne, 307 F. 2d 242 (6 Cir. 1962) 4

Statutes and Regulations

Federal Rules of Civil Procedure, Rule 8(e)(2) 2
Rules and Regulations under the Securities Exchange Act of 1934
Rule 10b-5, 17 CFR § 240.10b-5 .....2, 3, 6, 7 *passim*
Securities Exchange Act of 1934
§ 2, 15 USC § 78b 6
§ 10(b), 15 USC § 78j(b) ..... 2, 3, 4 *passim*
§ 18(a), 15 USC § 78r(a) 2

Miscellaneous

House of Representatives Report No. 1383, 73rd Cong., 2d Sess. (1934), p. 11 6
Restatement, Torts (1938) § 531, Comment (a) 11
Restatement, Torts 2d (1965) § 8A 11
Senate Report No. 1455, 73rd Cong., 2d Sess. (1934), p. 68 6

IN THE

Supreme Court of the United States

October Term, 1968

No. 894

EDWARD H. WEITZEN et al.,

Petitioners,

—against—

CHARLES HEIT et al.,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Opinions Below

The opinion of the Court of Appeals is reported, *Heit* v. *Weitzen*, 402 F. 2d 909 (2 Cir. 1968). The opinions of the District Court are reported, *Heit* v. *Weitzen*, 260 F. Supp. 598 (SDNY 1966), and *Howard* v. *Levine*, 262 F. Supp. 643 (SDNY 1965).

Statement of the Case

Since this consolidated case comes to the Court on a challenge to the legal sufficiency of the complaints (Pet. 5b, 1c), the allegations of the complaints must be taken as true and form the factual framework of the controversy. The petition strays far from the pleadings and the record. Actually the material facts are simple.

Petitioners, defendants below, are the Belock Instrument Corporation (Belock), its directors, officers, auditors and controlling stockholder (16a, 68a-70a).* Belock's stock and debentures are listed on the American Stock Exchange and are traded over the counter (16a, 70a). Petitioners materially falsified Belock's financial statements by adding fictitious profits from its Government contracts to its assets and earnings (17a, 71a-72a). Petitioners filed the false reports with the SEC and distributed them to the public (17a, 71a). They knew the statements to be false (18a, 72a).** They knew and intended that the false statements would artificially inflate the market price of Belock's securities (18a, 72a). They knew and intended, therefore, that numerous investors would be misled into buying the securities at the excessive prices. In reliance on petitioners' misstatements and on the integrity of the market price, respondents (plaintiffs below) and many other investors did buy the stock and debentures at the inflated prices, to their damage (18a, 73a).

Upon these allegations, respondents seek damages for themselves and other investors similarly deceived. The claim is based on §§ 10(b) and 18(a) of the Securities Exchange Act, 15 USC §§ 78j(b) and 78r(a), and SEC Rule 10b-5, 17 CFR § 240.10b-5.***

---

* The Appendix to respondents' brief below is cited as "—a".

** As held by the Court of Appeals (Pet. 8a-9a), the alternative allegation that defendants should have known the falsity of their representations may, under FRCP 8(e)(2), be ignored.

*** The text of § 10(b) and of Rule 10b-5 is set forth in the petition (p. 4). The petition raises no question concerning the claim under § 18(a).

The Question Presented

Section 10(b) and Rule 10b-5 make it unlawful to commit fraud "in connection with the purchase or sale of any security." Petitioners do not here dispute that their fraud was intended to and did induce numerous investors, including respondents, to purchase Belock's securities at inflated prices. Nevertheless, they contend that their fraud was not "in connection with the purchase or sale of any security" because they themselves did not buy or sell securities. This is the sole question the petition (p. 3) presents to the Court.

The arguments of the petition, however, range far beyond this single narrow issue. Petitioners also disclaim liability because Belock's losses, concealed from the public, resulted from its misconduct in dealing with the Government (Pet. 12-13, 18-19); and because petitioners' "purpose", "motive" or "desire" was to conceal their misconduct from the Government rather than to inflate the market price (Pet. 13). Out of precaution, we shall briefly discuss these arguments along with the question actually presented to the Court.

REASONS FOR DENYING THE WRIT

I

The question raised by the petition is insubstantial and has recently been answered by this Court.

1. Rule 10b-5 does not require "privity".

The question posed by the petition (p. 3) needs clarification. Petitioners do not contend that a 10b-5 claim depends on "privity" between the perpetrator and the victim of the fraud. In other words, a defrauded purchaser of securities need not have bought them from the wrongdoer in order to invoke the rule against him.

Petitioners are well advised not to rely on privity. Even the common law of fraud has long abandoned that requirement, *Fischer* v. *Kletz*, 266 F. Supp. 180, 187 (SDNY 1967), and the authorities under § 10(b) and Rule 10b-5 are virtually unanimous in rejecting it.*

Admittedly, therefore, it is no defense to the 10b-5 claims here alleged that respondents bought their Belock securities in the market rather than from petitioners.

2. Rule 10b-5 does not require a securities transaction by the wrongdoer.

With their foregoing concession, petitioners are driven to a novel interpretation of § 10(b) and Rule 10b-5. They

---

* *Texas Continental L. Ins. Co.* v. *Dunne*, 307 F. 2d 242, 249 (6 Cir. 1962); *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540, 543-4 (2 Cir. 1967); *Fischer* v. *Kletz*, 266 F. Supp. 180, 192-3 (SDNY 1967); *Brennan* v. *Midwestern United L. Ins. Co.*, 259 F. Supp. 673, 682-3 (N.D. Ind. 1966); *Bredehoeft* v. *Cornell*, 260 F. Supp. 557, 559 (D. Ore 1966); *Miller* v. *Bargain City*, 229 F. Supp. 33, 37 (E.D. Pa. 1964); *Freed* v. *Szabo Food Service*, 1961-64 CCH Fed. Sec. L. Rep. ¶ 91,317, at pp. 94,363-4 to 94,363-5 (N.D. Ill. 1964); *New Park Mining Co.* v. *Cranmer*, 225 F. Supp. 261, 266 (SDNY 1963). *But see Donovan, Inc.* v. *Taylor*, 136 F. Supp. 552, 553 (N.D. Cal. 1955).

say that defrauded purchasers of securities can sue only if the wrongdoer had securities dealings with *someone,* even though only with a third party. This theory, if accepted, would give petitioners the privilege to deceive the investing public with impunity provided only that they themselves did not buy or sell securities from or to someone.*

Petitioners do not explain why the wrongdoer's dealings with a third and wholly unrelated party should be relevant to his liability to his victim. The contention lacks any rational basis and defies common sense.

Nor does it find any basis in the language or purpose of the statute or rule. There is nothing magic or mysterious to the phrase "in connection with the purchase or sale of any security." Had these words been omitted from § 10(b), the statute would have applied to the fraud-induced purchase or sale of a horse or of land. Congress, however, intended to protect only defrauded purchasers or sellers of *securities.* The "in connection" clause was designed to express this limitation.

The requisite "connection" between the fraud and a securities transaction thus is the traditional causal connection. It exists if the fraud induces the defrauded person to buy or sell securities. This is the only "connection" the statute requires. According to petitioners, there must be a second connection; in addition to the fraud-induced securities transaction of the victim, they say, there must also be a fraud-connected securities transaction by the wrong-

---

* For instance, a corporation procuring a loan from a bank or factor by means of a false financial statement might well include that statement in its published annual report in order not to "tip off" the lender. On petitioners' theory, the investors induced by the false statement to buy the corporation's securities would be without remedy because the corporation itself had no securities transaction.

doer. The statute, however, prescribes only one connection, not two.

Petitioners' interpretation flies in the face of the manifest purpose of § 10(b) and Rule 10b-5. The Exchange Act is a remedial statute designed for the protection of investors; *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967). Indeed, § 10(b) itself expressly recites "the protection of investors" as its objective. The protection is to be insured by "the maintenance of fair and honest markets" in securities; § 2, 15 USC § 78b. As stated by the House Committee reporting on the 1934 legislation, "There cannot be honest markets without honest publicity * * *."*

Petitioners' false statements caused the artificial inflation of the market price of Belock's securities. Dishonest publicity thus created a dishonest market. This was the very evil from which investors such as respondents were to be protected.

Petitioners would carve an exception from the broad protection afforded investors by the Act. They claim that they had a license to deceive the market and to defraud investors because they did not buy or sell any securities. The Act permits no such distinction. To import a defense like this into the statute and rule would put a premium on dishonesty, contrary to the "philosophy of full disclosure" and the "high standard of public ethics in the securities industry" mandated by Congress; *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963). An investor buying securities on a national exchange ordinarily does not know the identity of his seller; his need for protection from fraud is no different whether or not the perpetrator

---

* H.R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934), p. 11. See also S. Rep. No. 1455, 73rd Cong., 2d Sess. (1934), p. 68.

happens to be a seller of securities. Giving controlling weight to adventitious circumstances such as these would permit—in the words of *SEC* v. *Howey Co.*, 328 U.S. 293, 301 (1946)—"the statutory policy of affording broad protection to investors * * * to be thwarted by unrealistic and irrelevant formulae."

3. A recent decision of this Court in effect rejects petitioners' position.

Petitioners fail to cite a single authority for their theory; nor do we find any in Judge Moore's dissent in *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 870 (2 Cir. 1968), on which petitioners stake their case.*

In *SEC* v. *National Securities, Inc.*, —— U.S. ——, 37 U.S. Law Week 4101 (Jan. 27, 1969), this Court dealt with the merger of two insurance companies, Producers Life and National Life. The SEC attacked the merger on the ground that the proxy statement issued to the stockholders of Producers withheld material information, in violation of § 10(b) and Rule 10b-5. The defendants contended that the alleged fraud was not "in connection with the purchase or sale of any security" (p. 4104); but this Court had no difficulty finding the connection (p. 4105):

---

* Judge Moore concluded his discussion of earlier authorities with the statement that "[i]n all of the above cases the defendants * * * were clearly participants in a securities transaction * * *" (401 F. 2d at 888). Even if this were true it would not prove that such participation was a necessary element of the 10b-5 fraud, unless the courts so treated it. None of them did. We submit, however, that Judge Moore misread some of his authorities. The defendant broker in *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215 (SDNY 1965), did not buy or sell any securities. Neither did any of the defendants in *Miller* v. *Bargain City*, 229 F. Supp. 33 (E.D.Pa. 1964). Neither did the defendant broker in *Glickman* v. *Schweickart & Co.*, 242 F. Supp. 670 (SDNY 1965), or the defendant finance company in *Cooper* v. *North Jersey Trust Co.*, 226 F. Supp. 972 (SDNY 1964), or the defendant accountants in *Fisher* v. *Kletz*, 266 F. Supp. 180 (SDNY 1967).

> "The deception furthered a scheme which resulted in their [the stockholders of Producers] losing their status as shareholders in Producers Life and becoming shareholders in a new company. Moreover, by voting in favor of the merger, each approving shareholder individually lost any right under Arizona law to obtain an appraisal of his stock and payment for it in cash. * * * here an alleged deception has affected individual shareholders' decisions in ways not at all unlike that involved in a typical cash sale or share exchange. The broad anti-fraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation."

The "connection" of the fraud with a securities transaction thus rested on the fact that the fraud induced the deceived investors to sell their shares. This Court did not so much as hint that additionally a sale or purchase of securities by the perpetrators of the fraud was necessary. The type of connection found sufficient in *National Securities* is, of course, equally present here.

National Securities, to be sure, involved a suit by the SEC rather than a private damage action; but this affords no distinction.* The requisite "connection" of the fraud with a purchase or sale of securities is the same in both types of litigation; the fortuitous presence or absence of securities dealings by the wrongdoer is as irrelevant when investors sue for themselves as when their interests are represented by the SEC.**

---

* Judge Moore's dissenting views in *Texas Gulf Sulphur* (401 F. 2d 833) related to an action by the SEC.

** None of the complex questions of "standing" to sue to which this Court adverted (note 9), arises in the present case. As indicated by the *Lowenfels* article cited by this Court (ibid.), a private investor's 10b-5 standing may or may not depend on his actually having bought or sold a security in reliance on the misrepresentations. Such purchases are here clearly alleged, so that respondents' "standing" is unquestioned.

In the light of *National Securities,* of the clear purpose of the statute and rule, and of plain common sense, we submit that the question posed by petitioners is too insubstantial to warrant review by this Court.

II

Petitioners are not relieved from 10b-5 liability because they also committed a fraud upon the Government.

In searching for exculpatory arguments, petitioners have devised a theory of remarkable boldness. Belock, it is alleged in the complaints, had large contracts with the Government; by cheating the Government, it derived fictitious profits from the contracts; and it included these non-existing profits among the assets and earnings it reported to the public. According to petitioners, the public has no ground to complain of Belock's false financial reports because the falsity arose from "corporate misconduct" (Pet. 12-13, 18-19).

Petitioners' own illustration will serve to answer them. According to the petition (p. 12):

> "If, for example, a corporate officer, *unbeknownst to anyone,* embezzles large sums from the corporate till, any balance sheet issued by the corporation prior to the discovery of the embezzlement will contain a false statement of the corporation's assets." (Emphasis added)

The key words here are "unbeknownst to anyone". The complaints allege knowledge on the part of all petitioners. It does not need argument that a known corporate loss, whether or not due to "corporate misconduct", cannot be intentionally withheld from the financial statements without consequent fraud liability under 10b-5. If an officer has stolen a million dollars from his corporation, the money

is no longer in the till, and it is fraud to misrepresent knowingly that it is still there.

It may, indeed, be unpleasant for those guilty of "corporate misconduct" to reveal their misdeeds to the public. So far, however, the duty of truth in corporate reporting has not been displaced by concern for corporate malefactors.

Petitioners complain *ad misericordiam* that corporate liability to investors defrauded by false reports may give rise to very large claims. Perhaps so; but Congress designed the Exchange Act to protect the investors, not the originators of false reports. Of course, liability presupposes culpability; whether that is actual knowledge or some degree of negligence need not here be resolved.

The "electrical equipment cases" are not the horrible examples made out by petitioners (Pet. 18-19). Complex antitrust cases often lie in a penumbra between legality and illegality, so that an officer's honest belief in the innocence of his conduct may excuse the lack of public revelation. No such excuse will avail petitioners, who simply charged the Government with fictitious expenses.

It is "of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley* v. *Gibson*, 355 U.S. 41, 45-46 (1957). It would be competent for respondents to prove a representation made by petitioners that Belock owed the Government no refunds under its contracts,* when petitioners actually knew that

---

* The SEC's amicus brief below (Note 43) referred to Belock's 1964 annual report issued in 1965, which recited:

> "Renegotiation proceedings for the fiscal years through October 31, 1963 have been completed. No provision for refunds for 1964 has been made or is believed necessary."

the Government had been fraudulently overcharged.* The question whether such proof or other evidence is available cannot be determined at this stage of the controversy, but must be left for the trial of the action.

III

Liability under Rule 10b-5 does not depend on a fraudulent purpose or motive on the part of the wrongdoer.

Petitioners (p. 13) suggest that they are not liable for their misstatements because they did not act "with the intention, desire, or for the purpose, of inducing purchases or sales of the corporate securities". Presumably, they claim that they "desired" only to withhold the fraud from the Government.

We submit that petitioners' "purpose" or "desire" is immaterial. The common law requires an "intention" to deceive (as distinguished from a purpose or motive); the intention, however, will be implied from a false representation knowingly made, "for the law presumes every man to intend the natural consequences of his acts". *Claflin* v. *Commonwealth Ins. Co.*, 110 U.S. 81, 95 (1884); *Agnew* v. *United States*, 165 U.S. 36, 53 (1897); *Restatement, Torts 2d*, § 8A (1965). Once this kind of intent is present, the "purpose" or "desire" of the perpetrator of the fraud is irrelevant; *Restatement, Torts* (1938), § 531, Comment (a):

> "Thus a person who believes that another is substantially certain to act in a particular way as a result of a misrepresentation intends such result although he did not act for the purpose of causing it or even if he did not desire it."

---

* Belock's principal officers have been convicted of such fraud against the Government or have pleaded guilty (Pet. 5-6).

The present complaints allege petitioners' "intent" to cause an artificial inflation of the market price (18a, 72a), i.e., their intent to cause purchases and sales at the inflated prices. Under the common law authorities, no further purpose or desire is necessary.

Since § 10(b) and Rule 10b-5 are designed to strengthen the protection of investors, their requirements cannot be stricter than those of the common law. Indeed, the lower courts are in virtual agreement that "[i]n an action brought under section 10(b), common law fraud need not be alleged or ultimately proved."* It would thus be the height of incongruity to read into Rule 10b-5 a requirement of fraudulent "purpose", which even the common law rejects.

CONCLUSION

The writ of certiorari should be denied.

Dated: February 7, 1969.

Respectfully submitted,

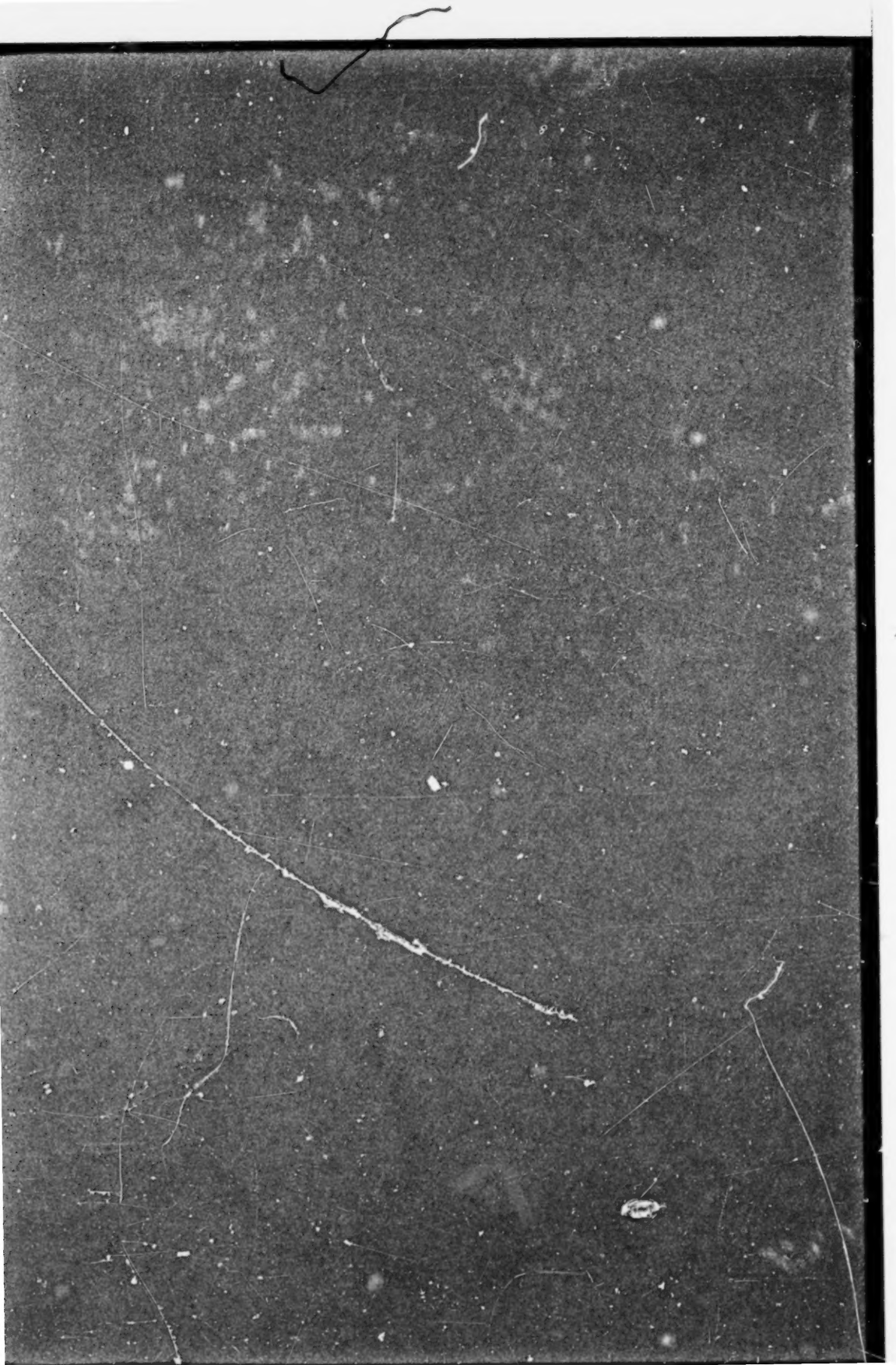
WILLIAM E. HAUDEK,
Attorney for Respondents Charles Heit, Betty Volk and Helen Howard.

Of Counsel:

POMERANTZ LEVY HAUDEK & BLOCK,
ARTHUR W. LICHTENSTEIN,
LAWRENCE MILBERG.

---

* *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210, 212 (9 Cir. 1962); *Stevens* v. *Vowell*, 343 F. 2d 374, 379 (10 Cir. 1965); *Kohler* v. *Kohler Co.*, 319 F. 2d 634, 637 (7 Cir. 1963); *Myzel* v. *Fields*, 387 F. 2d 718, 734-5 (8 Cir. 1967), cert. den. 390 U.S. 951 (1968); *Lorenz* v. *Watson*, 258 F. Supp. 724, 731 (E.D. Pa. 1966).



INDEX

	Page
Statement	1
Discussion	5
Conclusion	14

CITATIONS

Cases:

Ambrosia Minerals, Inc., 39 S.E.C. 734 — 8
Beury v. *Beury*, 222 F. 2d 464 — 6
Ellis v. *Carter*, 291 F. 2d 270, dismissal affirmed, 328 F. 2d 573 — 6
Eureka Co., 38 S.E.C. 475 — 8
Fischman v. *Raytheon Mfg. Co.*, 188 F. 2d 783 — 6
Great American Industries, Inc. v. *Securities and Exchange Commission*, No. 1195, this term — 7
Great Sweet Grass Oils, Ltd., 37 S.E.C. 683, affirmed *per curiam*, 256 F. 2d 893 — 8
Hooper v. *Mountain States Securities Corp.*, 282 F. 2d 195, certiorari denied, 365 U.S. 814 — 6
J. I. Case Co. v. *Borak*, 377 U.S. 426 — 6, 13
Janigan v. *Taylor*, 344 F. 2d 781, certiorari denied, 382 U.S. 879 — 6
Jordan Bldg. Corp. v. *Doyle, O'Connor & Co.*, 401 F. 2d 47 — 6
McClure v. *Borne Chemical Co.*, 292 F. 2d 824, certiorari denied, 368 U.S. 939 — 6
Myzel v. *Fields*, 386 F. 2d 718, certiorari denied, 390 U.S. 951 — 6
Securities and Exchange Commission v. *Capital Gains Bureau*, 375 U.S. 180 — 12
Securities and Exchange Commission v. *Electrogen Industries, Inc.*, CCH Fed. Sec. L. Rep. ¶ 92,156 — 10
Securities and Exchange Commission v. *National Securities, Inc.*, 393 U.S. 453 — 6, 12, 13

339-588—69——1

Cases—Continued
Securities and Exchange Commission v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, petitions for certiorari pending, *sub nom. Coates* v. *Securities and Exchange Commission*, No. 897, this Term, and *Kline* v. *Securities and Exchange Commission*, No. 937, this Term. 4
Stevens v. *Vowell*, 343 F. 2d 374 6
Surowitz v. *Hilton Hotels Corp.*, 383 U.S. 363 6
Tcherepnin v. *Knight*, 389 U.S. 332 6, 12
Texas Continental Life Insurance Co. v. *Dunne*, 307 F. 2d 242 6
Statutes and rules:
Securities Act of 1933:
Section 17(a), 15 U.S.C. 77q(a) 12
Securities Exchange Act of 1934:
Section 2, 15 U.S.C. 78b 6, 7
Section 9(a)(4), 15 U.S.C. 78i(a)(4) 12
Section 10(b), 15 U.S.C. 78j(b) 1, 3, 4, 5, 6, 10, 11, 12
Section 13, 15 U.S.C. 78m 8
Section 15(c)(5), 15 U.S.C. 78o(c)(5) 9
Section 15(d), 15 U.S.C. 78o(d) 8
Section 18(a), 15 U.S.C. 78r(a) 13
Section 19(a)(4), 15 U.S.C. 78s(a)(4) 9
Federal Rule of Civil Procedure 8(e)(2) 3
Rules Under the Securities Exchange Act of 1934:
Rule 10b–5, 17 CFR 240.10b–5 2, 3, 4, 5, 6, 10
Rules 13a–1 to 13b–1, 17 CFR 240.13a–1 to 240.13b–1 8
Rules 15d–1 to 15d–21, 17 CFR 240.15d–1 to 240.15d–21 8
Legislative History:
Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720, 73d Cong., 2d Sess 11
Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) *and S. Res. 56 and 97* (73d Cong.), 73d Cong., 1st and 2d Sess. 11
H.R. 9323 § 9, 73d Cong., 2d Sess 11
H. Rep. No. 1383, 73d Cong., 2d Sess 8, 10
H. Rep. No. 1838, 73d Cong., 2d Sess 11
S. 3420, § 10(b), 73d Cong., 2d Sess 11
S. Rep. No. 379, 88th Cong., 1st Sess 9, 10
S. Rep. No. 1455, 73d Cong., 2d Sess 8

Miscellaneous:
Loss, *Securities Regulations* (2d ed. 1961)..... 8
Securities Exchange Act Release No. 7632 (June 22, 1965)..... 9
Securities Exchange Act Release No. 7741 (November 4, 1965)..... 9

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 894

EDWARD H. WEITZEN, ET AL., PETITIONERS

v.

CHARLES HEIT, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES AND THE SECURITIES AND EXCHANGE COMMISSION

This memorandum is submitted in response to the Court's order of February 24, 1969, inviting the Solicitor General to express the views of the United States. We believe that the decision of the court of appeals was correct and that the petition for a writ of certiorari should be denied.

STATEMENT

The petition arises out of three private actions brought under the federal securities laws against petitioners and two of the respondents. The complaints in the three actions allege, among other things, violations of Section 10(b) of the Securities Exchange

Act of 1934, 15 U.S.C. 78j(b), and the Commission's Rule 10b–5 thereunder, 17 CFR 240.10–5.[1] The complaints in all three actions (two of which had been consolidated) were dismissed in the district court for failure to state a claim upon which relief could be granted (Pet. App. 1b–15b, 1c–3c). The court of appeals reversed the district court decisions and remanded the cases for further proceedings (Pet. App. 1a–16a).

The pertinent allegations of the complaints, which "are substantially the same" (Pet. 7–8), are as follows.[2] Defendant Belock Instrument Corporation ("Belock") is a publicly-owned corporation engaged principally in the manufacture and sale of precision and other instruments and components (16a; 68a, 70a). Its common stock and debentures are listed on the American Stock Exchange (16a; 70a). The other defendants are or were officers, directors, controlling shareholders or auditors of the corporation (16a; 68a–70a). Belock derived over 90 percent of its sales from government contracts, which included price redetermination clauses providing for separate review of the amounts paid under each contract (70a). In setting forth the results of this business for the period November 1, 1963, to January 31, 1965, Belock substan-

[1] Section 10(b) and Rule 10b–5 are set out at pages 4–5 of the petition. Since the petition does not raise any question about any of the other provisions involved in the litigation below, we shall not deal with them here.

[2] The complaints are set forth in the appendix to the brief of the plaintiffs-appellants in the court of appeals, which is cited in this memorandum as "—a." The appendix to the petition for a writ of certiorari is cited herein as "Pet App. —."

tially overstated its net assets and past and prospective income by including earnings, income and assets resulting from substantial overcharges to the United States Government (17a; 70a–72a). All the defendants knew that this financial information was false (18a; 72a).[3] They "caused [the false information] to be circulated and disseminated to the public-at-large through press releases, statements to the investment community, quarterly and other financial reports and through other media of communication to the public * * *;" it was also included in reports filed with the Commission and the American Stock Exchange (17a; 71a). The dissemination of the press releases, statements and reports "was intended to, and did, have the effect of artificially inflating the market prices" of Belock securities (18a). Plaintiffs purchased Belock securities at these prices in reliance upon the false and misleading information (18a; 73a).

Section 10(b) and Rule 10b–5 prohibit false statements "in connection with the purchase or sale of any security." Both district judges below dismissed the complaints because

> the gravamen of defendants' activities [are not alleged] to be any wise "in connection with the purchase or sale of any security" as those words have been construed in their statutory setting. Whatever fraud is alleged here (it is in bare skeletal form) is directed against the government, notwithstanding its possible incidental

[3] Although actual knowledge and reason to know were alleged in the alternative, the court of appeals accepted this as an adequate allegation of the former (Pet. App. 8a–9a). See Fed. R. Civ. P. 8(e)(2).

> market impact. Furthermore, defendants or persons associated with them did not participate in the security transactions involved [Pet. App. 2c].[4]

The court of appeals reversed on the ground that the district judges had read the "in connection with" phrase of Section 10(b) and Rule 10b–5 too restrictively, stating that

> [i]t is reasonable to assume that investors may very well rely on the material contained in false corporate financial statements which have been disseminated in the market place, and in so relying may subsequently purchase securities of the corporation. * * * [Pet. App. 7a.]

Referring to its recent en banc decision in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833,[5] the court held that the "in connection with" requirement was satisfied "whenever a device was employed 'of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities' * * *" (Pet. App. 6a–7a). The court of appeals added that "[t]here is no

---

[4] This language of the first district judge was adopted by the second, who added that the complaint before him was "devoid of the statement of any facts that the fraud complained of was perpetrated by the defendants 'in connection with any purchase or sale'" of securities (Pet. App. 8b).

[5] Two of the individual defendants in that case have petitioned the Court for certiorari. *Coates* v. *Securities and Exchange Commission*, No. 897, this Term; *Kline* v. *Securities and Exchange Commission*, No. 937, this Term. The Commission has filed briefs in opposition to both petitions. Neither petition raises the "in connection with" issue. Although the issue is posed in that case by the court of appeals' decision with respect to the issuance of a corporate press release, the corporation has not petitioned for certiorari.

necessity for contemporaneous trading in securities by insiders or by the corporation itself" (Pet. App. 7a). It also stated that

> [t]he "ulterior motive" present in the instant case—the concealment of the fraud from the government—is irrelevant, since the false information was circulated to a large segment of the investing public. It is impossible to isolate the particular "fraudulent" acts and consider them as directed toward the government alone [Pet. App. 7a].

Finally, the court of appeals deferred any consideration of the issue of damages until after the facts had been fully developed in the trial of the cases (Pet. App. 15a & n. 8).

DISCUSSION

Petitioners' basic contention is that, because they did not trade in Belock's securities or primarily seek to deceive investors, they have not violated Section 10(b) and Rule 10b–5. Consequently this petition poses the question whether in these circumstances the securities laws prohibit a corporation whose securities are traded in the markets, and its officials, from disseminating information about its affairs that is known by them to be false and is reasonably likely to influence the investing public.

The quality of corporate information made available to the investing public and the authority of the Commission and the courts to police much of the information upon which investment decisions are based turn in large part on the answer to this question. This case involves both corporate reports that were filed

339-588—69——2

with the Commission and other public statements that were not. Filed public statements by corporations are subject to other provisions of the Act in addition to Section 10(b). If there were circumstances in which unfiled public statements by corporations were immune from the securities laws and the Commission's rules implementing those laws, there would be a large gap in the "reasonably complete and effective"[6] statutory framework established by Congress for the protection of the investing public.[7]

The question presented by this petition arises from the dismissal of the complaints in the district court,

[6] Section 2 of the Act, 15 U.S.C. 78b.

[7] Petitioners do not attempt to distinguish between the power of the Commission to deal with unfiled public statements by corporations and the right of investors injured by a violation of the statute and rule to sue to recover their damages (*e.g.*, Pet. 13). This Court has already held that a private right of action exists under the proxy provisions of the Act. *J. I. Case Co.* v. *Borak*, 377 U.S. 426. Although it has never expressly decided whether a private right of action is similarly implied for violations of Section 10(b) and Rule 10b–5, it has upheld complaints claiming that right, without discussion of the question. *Surowitz* v. *Hilton Hotels Corp.*, 383 U.S. 363; *Tcherepnin* v. *Knight*, 389 U.S. 332; cf. *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 471, n. 4 (opinion of Mr. Justice Harlan). Every court of appeals that has considered the issue has held that this remedy exists. *E.g.*, *Janigan* v. *Taylor*, 344 F. 2d 781 (C.A. 1), certiorari denied, 382 U.S. 879; *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C.A. 2); *McClure* v. *Borne Chemical Co.*, 292 F. 2d 824 (C.A. 3), certiorari denied, 368 U.S. 939; *Beury* v. *Beury*, 222 F. 2d 464 (C.A. 4); *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *Texas Continental Life Ins. Co.* v. *Dunne*, 307 F. 2d 242 (C.A. 6); *Jordan Bldg. Corp.* v. *Doyle, O'Connor & Co.*, 401 F. 2d 47 (C.A. 7); *Myzel* v. *Fields*, 386 F. 2d 718 (C.A. 8), certiorari denied, 390 U.S. 951; *Ellis* v. *Carter*, 291 F. 2d 270 (C.A. 9), dismissal affirmed, 328 F. 2d 573 (C.A. 9); *Stevens* v. *Vowell*, 343 F. 2d 374 (C.A. 10).

and thus does not involve the troublesome problems that might arise upon trial. For the reasons stated below, it is our view that the court of appeals properly held that a claim is stated under Section 10(b) and Rule 10b–5. Since no other court of appeals has ruled upon the question,[8] and since the decision below is correct, further review by this Court is not required.

1. Transactions in widely held securities are continually taking place in the markets. In giving effect to the purpose of the Act "to insure the maintenance of [these markets as] fair and honest, * * *"[9] Congress recognized that it was essential to provide the investing public with complete and accurate information about securities and their issuers. Thus, in reporting favorably on the Act, the House committee stated:

> The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of impor-

[8] The question has also been posed in the petition for certiorari in *Great American Industries, Inc.* v. *Securities and Exchange Commission*, No. 1195, this Term, although the corporate statements published in that case were related to securities transactions by the defendant corporation. The Commission will point out in its opposition to that petition that the broad "in connection with" question posed here is not necessarily involved in that case.

[9] Section 2 of the Act, 15 U.S.C. 78b.

tant information obstructs the operation of the markets as indices of real value. *There cannot be honest markets without honest publicity* * * *. [H. Rep. No. 1383, 73d Cong., 2d Sess. (1934), p. 11 (emphasis added).] [10]

Congress dealt with this problem in part by providing in Sections 13 and 15(d) of the Act, 15 U.S.C. 78m, 78o(d), for periodical and other reports by widely held corporations, and the Commission has established a detailed reporting system under these provisions.[11] These reports, some of which are involved here, are placed in the Commission's public files for the very purpose of being available for use by investors in their own securities transactions. It is, of course, implicit in the reporting requirements that the documents filed with the Commission must be complete and accurate.[12]

Although this reporting system establishes a permanent record of the most important information about the subject corporations and a framework within which other information can be assessed, the reports necessarily are only a small part of the information that corporations make available to the investing public about their affairs. The nature and timing of

---

[10] Cf. S. Rep. No. 1455, 73d Cong., 2d Sess. (1934), p. 68.

[11] See Rules 13a–1 to 13b–1, 15d–1 to 15d–21, 17 CFR, 240.13a–1 to 240.13b–1, 240.15d–1 to 240.15d–21.

[12] *E.g.*, *Ambrosia Minerals, Inc.*, 39 S.E.C. 734–735 n. 1; *Eureka Co.*, 38 S.E.C. 475, 476 n. 2; *Great Sweet Grass Oils, Ltd.*, 37 S.E.C. 683, 684 n. 1, affirmed *per curiam*, 256 F. 2d 893 (C.A. D.C.). Suits have been brought by the Commission to compel the filing of reports that are accurate and in conformity with its regulations. 2 Loss, *Securities Regulation* (2d ed. 1961), pp. 846–847 & n. 208.

the reporting system limit its effectiveness for the desirable rapid and widespread dissemination of material information to the investing public. Therefore, corporations commonly make the initial announcements of important developments in press releases and other informal statements. And, if information contained in a filed report has not been disclosed previously, a press release is often issued in conjunction with the filing. It would probably not be feasible to require corporations to file every public statement with the Commission.

Congress recognized that the reporting system would not be sufficient to rid the markets of false information about securities. Accordingly, it gave the Commission power to suspend trading in securities, both on the exchanges and in the over-the-counter markets.[13] Such suspensions are designed "to prevent fraud" by immediate action "when fraudulent or manipulative practices of the issuer or other persons have deprived * * * [a] security of a fair and orderly market, or when some corporate event has made informed trading impossible and has created conditions in which investors are likely to be deceived." S. Rep. No. 379, 88th Cong., 1st Sess. (1963), pp. 26, 66. The suspension device was intended, however, to serve

[13] Sections 15(c)(5) and 19(a)(4) of the Act, 15 U.S.C. 78o(c)(5), 78s(a)(4). The Commission suspended trading in Belock securities when it first learned of the overcharges, "which will have a material adverse effect on the financial condition of the company as well as on its published prior earnings reports" and later lifted the trading ban "in view of * * * [subsequent filings and other] disclosures by the company." Securities Exchange Act Release No. 7632 (June 22, 1965), No. 7741 (Nov. 4, 1965).

only as a stop-gap measure to afford a breathing period until adequate disclosures could be made; Congress did not want the Commission to keep suspensions of trading in effect indefinitely.[14] There would, however, be no other way to protect the public in such situations unless, as the court below correctly held, Section 10(b) and Rule 10b–5 are generally applicable to corporate statements reasonably likely to affect the market.[15]

2. The legislative history indicates that Section 10(b) was intended to be as broad as the Act itself. Congress recognized that the various existing abuses in the securities markets were "all a single seamless web," [16] and that the various provisions of the Act designed to deal with particular abuses would have to complement each other. As the House committee stated, "No one of these evils can be isolated for cure of itself alone." [17] Thus, Congress could not have intended to give the Commission power to enforce the reporting requirements but not to police other corporate statements covering the same subject matter with an equal or greater impact upon the investing public and upon the securities markets.

Section 10(b) was intended to achieve the overall congressional objective by filling any gaps left by the specific provisions. In describing the section (as orig-

---

[14] S. Rep. No. 379, 88th Cong., 1st Sess. (1963), pp. 25–26, 66–67.

[15] The relationship between the suspension power and the antifraud provisions is demonstrated by *Securities and Exchange Commission* v. *Electrogen Industries, Inc.*, CCH Fed. Sec. L. Rep. ¶92,156 (E.D. N.Y., Feb. 26, 1968).

[16] H. Rep. No. 1383, 73d Cong., 2d Sess. (1934), p. 6.

[17] *Ibid.*

inally introduced) before the House committee, Thomas G. Corcoran, one of the draftsmen of the Act, noted that it provided in effect, "Thou shalt not devise any other cunning devices." [18] Representatives of the securities industry complained that this provision would give the Commission power to prohibit virtually anything,[19] and the House then attempted to limit it.[20] In conference, however, the Senate version, which then gave the Commission rule-making power to prohibit "any manipulative or deceptive device or contrivance," S. 3420, § 10(b), 73d Cong., 2d Sess. (1934), was accepted by the House.[21] That version was enacted.

Petitioners argue that the "in connection with" phrase severely limits the application of the statute and rule; they read that phrase to require securities transactions by the corporation or its officials or a conscious purpose to affect securities transactions by others (Pet. 13–16).

Although we have found no specific legislative history indicating the reason for the inclusion of the "in connection with" phrase, it seems apparent that, in the absence of such a phrase, Section 10(b) would be universally applicable: it would authorize the Commis-

[18] *Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720*, 73d Cong., 2d Sess. (1934), p. 115.

[19] *Id.* at 178, 208–209, 251, 258, 297, 305; *Hearings Before the Senate Committee on Banking and Currency on S. Res. 84* (72d Cong.) *and S. Res. 56 and 97* (73d Cong.), 73d Cong., 1st and 2d Sess. (1933–1934), pp. 6624, 6634, 6899, 6910, 6936–6938, 6988.

[20] See H.R. 9323, § 9, 73d Cong., 2d Sess. (1934).

[21] See H. Rep. No. 1838, 73d Cong., 2d Sess. (1934), pp. 32–33.

sion to promulgate rules and regulations prohibiting all kinds of manipulative or deceptive devices regardless of whether any securities transactions were affected. Since Congress did not intend the Act to be applicable to situations bearing no relation to securities transactions, it was necessary to insert some such limiting language in Section 10(b). If Congress had sought to do more than this by withdrawing the protection of Section 10(b) when there is no corporate trading or purpose to injure investors, it could have used the phrase "*in* the offer or sale of any securities" or the phrase "*for the purpose of* inducing the purchase or sale of such security," as it did in other provisions of the securities acts.[22] But to read these restrictive phrases into the much broader language actually used in Section 10(b) would be contrary to the teaching of this Court that federal securities legislation, "'enacted for the purpose of avoiding frauds,' [should be construed] not technically and restrictively, but flexibly to effectuate its remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Bureau,* 375 U.S. 180, 195 (footnote omitted); *Tcherepnin* v. *Knight, supra,* 389 U.S. at 336.

Nor is avoidance of overlap with other provisions of the securities laws any reason why Section 10(b) should be narrowly construed. As this Court recently pointed out in *Securities and Exchange Commission v. National Securities, Inc., supra,* "The fact that there may well be some overlap is neither unusual

---

[22] Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q (a); Section 9(a)(4) of the Securities Exchange Act of 1934, 15 U.S.C. 78i(a)(4) (emphasis added in both).

nor unfortunate." 393 U.S. at 468. And cf. *J. I. Case Co.* v. *Borak, supra,* where the allegedly false proxy statement, like the corporate reports in this case, had been filed with the Commission and was thus also subject to Section 18(a) of the Act, 15 U.S.C. 78r(a).

3. Petitioners also argue that the decision below will transform any significant case of corporate misconduct or mismanagement into a violation of the federal securities laws because, whether or not the appropriate corporate officials are aware of the situation, the corporation's financial statements will be false or misleading if they fail to disclose the misconduct or mismanagement (Pet. 11–13, 17). It is not necessary in this case, however, for the Court to consider the broad issue framed by petitioner's argument. The financial statements in this case contained affirmatively false figures and other representations with respect to the amounts due Belock from the government and Belock's liability for renegotiation, and the complaints allege that the defendants knew that the information that they were disseminating was false (see p. 3, *supra*). It is only this factual situation that is presented by the petition.

4. Finally, petitioners contend that the decision below will expose publicly owned corporations and their officials to very large monetary liabilities (Pet. 17–19). The court of appeals recognized, however, that it might be appropriate to apply special rules of damages to situations such as this; at the suggestion of the Commission, which was participating *amicus curiae,* it determined not to resolve the difficult and complex question of damages on the basis

of the bare allegations of the complaint (Pet. App. 15a & n. 8). We do not believe that this Court should attempt to deal with this issue before the courts below have had an opportunity to do so.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

PHILIP A. LOOMIS, JR.,
General Counsel,
DAVID FERBER,
Solicitor,
DONALD M. FEUERSTEIN,
Assistant General Counsel,
HARVEY A. ROWEN,
Attorney,
Securities and Exchange Commission.

APRIL 1969.

U.S. GOVERNMENT PRINTING OFFICE: 1969

LIBRARY
REME COURT. U. S.

FILED
APR 30 1969
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 894

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

CHARLES HEIT, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

BETTY VOLK, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

STANLEY R. GRANT, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, CARL M. LOEB, RHOADES & CO., a partnership, and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

HELEN HOWARD and WALTER V. TYMINSKI,

Respondents.

PETITIONERS' REPLY TO MEMORANDUM FOR THE UNITED STATES AND THE SECURITIES AND EXCHANGE COMMISSION

Of Counsel:
CAHILL, GORDON, SONNETT, REINDEL & OHL
DAVID R. HYDE
IMMANUEL KOHN
80 Pine Street
New York, New York 10005

Of Counsel:
CARTER, LEDYARD & MILBURN
JOHN F. X. PELOSO
2 Wall Street
New York, New York 10005

Of Counsel:
KOSTELANETZ & RITHOLZ
52 Wall Street
New York, New York 10005

Of Counsel:
MENDES & MOUNT
JOHN F. BYRNE
27 William Street
New York, New York 10005

JOHN F. SONNETT
80 Pine Street
New York, New York 10005
Attorney for Petitioners Stanley R. Grant and Carl M. Loeb, Rhoades & Co.

DEVEREUX MILBURN
2 Wall Street
New York, New York 10005
Attorney for Petitioners Edward H. Weitzen and Jack J. Fischer

BORIS KOSTELANETZ
52 Wall Street
New York, New York 10005
Attorney for Petitioner Belock Instrument Corporation

WILBUR H. HECHT
27 William Street
New York, New York 10005
Attorney for Petitioner Lybrand, Ross Bros. & Montgomery

April 30, 1969

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 894

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

CHARLES HEIT, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

EDWARD H. WEITZEN, STANLEY R. GRANT, JACK J. FISCHER and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

BETTY VOLK, WALTER V. TYMINSKI and MARVIN J. LEVY,

Respondents.

STANLEY R. GRANT, LYBRAND, ROSS BROS. & MONTGOMERY, a partnership, CARL M. LOEB, RHOADES & Co., a partnership, and BELOCK INSTRUMENT CORPORATION,

Petitioners,

—against—

HELEN HOWARD and WALTER V. TYMINSKI,

Respondents.

PETITIONERS' REPLY TO MEMORANDUM FOR THE UNITED STATES AND THE SECURITIES AND EXCHANGE COMMISSION

Petitioners respectfully submit this memorandum in reply to the memorandum submitted by the Solicitor General for the United States and the Securities and Exchange Commission.

Section 10(b) of the Securities Exchange Act and Rule 10b-5 have recently become the focal point of a multitude of private class actions for monetary damages in the district courts—to the practical exclusion of the other provisions of the Federal Securities Acts and of developing common law principles. They constitute "one of the most important and elusive provisions of the securities laws." *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 470 (opinion of Mr. Justice Harlan).

The Solicitor General's memorandum recognizes that this petition squarely raises an important question of interpretation under Section 10(b) and Rule 10b-5 which, if the decision below stands, will give rise to "troublesome problems" (Memorandum of Solicitor General, p. 7). It also points out that that question is not necessarily reached in the petition for certiorari filed in *Securities and Exchange Commission* v. *Great American Industries, Inc.* (No. 1195) and was not presented by the recently denied petitions in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.* (Nos. 897 and 937) (neither of which, of course, involved private damage actions). (*Id.* pp. 4n, 7n)

Nevertheless, the Solicitor General urges this Court to deny review here because he believes the decision below to be "correct" and because no other court of appeals has ruled on the question (*Id.*, p. 7). The latter point, given the fact that Rule 10b-5 was adopted in 1942 (Section 10(b) not being self-operative), merely serves to demonstrate that the result reached below represents an unprecedented expansion of the Act to encompass causes of action never until recently asserted in any court.

In trying to justify the alleged "correctness" of the decision below, the Solicitor General's memorandum attempts

to reframe the question presented by the petition. The express requirement of both Section 10(b) and Rule 10b-5 that the forbidden manipulative or deceptive device be used or employed "in connection with the purchase or sale" of a security is equated with a requirement simply that the corporate and individual defendants, not themselves purchasers or sellers, be responsible (whether by omission or commission) for information "reasonably likely to influence the investing public" (*Id.*, p. 5) or "reasonably likely to affect the market" (*Id.*, p. 10).

Further, the question sought to be framed by the Solicitor General's memorandum is in terms of the effectiveness of the prohibitions of "the securities laws" (*Id.*, p. 5), not the Section and Rule which are in issue. The suggestion is that if this Court considers the question presented, and agrees with petitioners, effective enforcement of the securities laws will come to an end. To color the issue in this fashion is, we submit, to concede its significance.

Despite such suggestions to which the Solicitor General's memorandum is largely devoted, the question posed by the petition does not intrude upon the powers of the Securities and Exchange Commission to insure adequate disclosure under the Securities Exchange Act and the other legislation it administers. The recently issued Report of the Commission's Special Study Group under the direction of Commissioner Wheat, *Disclosure to Investors, A Reappraisal of Federal Administrative Policies under the '33 and '34 Acts,* concludes that presently available procedures are adequate for the purpose. For example, particular mention is made in the Report of the efficacy of the trading suspension procedure, which the Solicitor General's memorandum discounts, and of Section 15(c)(4)

of the Securities Exchange Act (enacted in 1964) which permits the Commission to issue orders requiring adequate reporting.

We submit that the alleged "correctness" of the decision below is belied by the "troublesome problems" it concededly gives rise to. These actions are private actions brought solely to collect damages. The financial statements involved here are not unusual. They are balance sheets and income statements—the prompt publication of which is urged by the stock exchanges and the Commission—of a going concern. They were not prepared in connection with any offering of securities and were not used by any defendant or by anyone connected with any defendant to effectuate offers or sales of securities. As it happened, certain of the company's executives, not the petitioners, had embarked upon a scheme to defraud the government in the costing of defense contracts, not to commit fraud in any securities transaction. The complaint is based solely on the alleged failure of the company's financial statements to reveal the frauds or the contingent liabilities.*

Similar allegations with respect to financial statements could be made had a corporate president been embezzling from the corporation and covering his tracks so that the financials failed to reflect this. The same would be true of any contingent liability of a corporation (totally un-

* The Solicitor General's memorandum (p. 13) states that the Belock financials in question here contained "affirmatively false figures" and false representations with respect to Belock's "liability for renegotiations". The fact is that the financial statements were erroneous only to the extent that they failed to reflect prior fraud on the government and the claims that the government would have against Belock as a result thereof. Obviously, there was no "affirmative representation" as to whether or not the company had defrauded the government.

related to any securities transaction) which was not specified in the corporation's financial statements. In any such situation the effect of disclosure on the aggregate market price of the corporation's stock (which would depend in large part on psychological and other intangible factors) would bear no necessary relationship to the actual amount of the corporation's loss.

To subject the corporations, their officers, directors and accountants (or, one might add as an example, financial journals which report their affairs, *cf.* 3 Loss *Securities Regulations* (2d ed. 1961), 1791 n. 362), *none of whom were engaged in any purchase or sale of securities,* to potential damage liability of staggering, albeit unpredictable, dimension in favor of securities traders in such situations does, indeed, pose "troublesome problems"—problems which may not be present in an action by the Commission or others for equitable relief where a lesser showing may be justified in establishing a 10(b) cause of action.* We submit that the proper procedure is not to establish a holding that liability for monetary damages exists on the part of such persons and then wrestle with the problems that holding creates, but to consider at the outset whether or not, in view of the very great problems which would be created, such a rule is correct and required by the Act and by Rule 10b-5.

---

* *Cf. SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193 (1963) ("It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages.") The decision below is based upon the interpretation by Judge Medina of the opinion of Judge Waterman (for himself and three other judges of the nine active judges of the Second Circuit) in the en banc decision in *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833—a suit in equity by the Commission.

Dozens, if not hundreds, of damage actions have recently been filed and are pending in the district courts which, as to defendants who did not themselves purchase or sell securities, stand or fall on the question here presented for review. Unlike those actions which the Commission is expressly authorized to bring by Section 21 of the Act in performance of its administrative functions, where there is no question of standing to sue, these are actions brought by private parties solely to collect damages. They are premised upon an implied right of action which has been derived by lower courts from Section 10(b) and Rule 10b-5 in situations where the defendants were themselves buyers or sellers of securities, or participants in a securities transaction.* These actions purport to be brought on behalf of large classes of security holders supposedly similarly situated and represented by the nominal plaintiffs. Typically the complaints seek to state a claim on behalf of all those who during long periods of time bought or sold securities which are often heavily traded and for many and undecipherable reasons rapidly fluctuating in price. They assert claims for many hundreds of millions of dollars, indeed very likely billions of dollars, for which publicly traded companies, directors, salaried executives and professional firms are asked to respond.

These cases, like this one, allege that defendant corporations, officers, directors and auditors "knew or should have

---

* As pointed out in the Solicitor General's memorandum (p. 6n), this Court has never expressly decided whether such an action may be implied and *a fortiori* either the substantive standards of liability to be applied or such concomitant procedural questions as the applicable statute of limitations. In *SEC* v. *National Securities, Inc., supra,* an action by the Commission, it was pointed out that: "This case presents none of the complications which may arise in determining who, if anyone, may bring actions under § 10 (b) and Rule 10b-5." (393 U.S. at 467 n. 9)

known"* of some corporate misstatement or omission and are liable for monetary damages under Section 10(b) for not causing corporate reports and releases to state the facts which are now asserted to be correct. Whether such damage liability should be imposed against defendants who have not purchased or sold any securities and who are not even alleged to have made any misstatement in connection with any sale or purchase of securities by themselves or anybody affiliated with them, whether problems of disclosure enforcement suggested in the Solicitor General's memorandum are in fact adequately dealt with under existing law and Commission rules as the Wheat Report concludes, or whether amendment of the securities laws is the answer as suggested in Mr. Milton H. Cohen's recent article, *"Truth in Securities Revisited"*, 79 Harv. L. Rev. 1340, 1369-70 (1966), are aspects of the question presented by the petition here.

As this Court recently noted in the first and only Section 10(b) case to come before it, "§ 10(b) and Rule 10b-5 may well be the most litigated provisions in the federal securities laws", *Securities and Exchange Commission* v. *National Securities, Inc., supra,* 393 U.S. at 465 (1969). We respectfully submit that this is the appropriate occasion and case for this Court to review the direction which the lower courts, heretofore without this Court's guidance, are taking in the construction and application of Section 10(b) and Rule 10b-5 and to define the proper scope and application of the Section and Rule.

---

* While the decision below and the Solicitor General's memorandum focus on the word "knew", thereby attempting to avoid the additional "troublesome question" of whether or not liability for damages in negligence exists under 10(b), it is apparent that these and other pending cases are proceeding to trial, at least as to most defendants, with at best a hope by the plaintiffs of showing negligence.

CONCLUSION

The writ of certiorari should issue.

Respectfully submitted,

JOHN F. SONNETT
Attorney for Petitioners
Stanley R. Grant and Carl M. Loeb,
Rhoades & Co.

Of Counsel:

CAHILL, GORDON, SONNETT,
REINDEL & OHL
David R. Hyde
Immanuel Kohn

DEVEREUX MILBURN
Attorney for Petitioners
Edward H. Weitzen and
Jack J. Fischer

Of Counsel:

CARTER, LEDYARD & MILBURN
John F. X. Peloso

BORIS KOSTELANETZ
Attorney for Petitioner
Belock Instrument Corporation

Of Counsel:

KOSTELANETZ & RITHOLZ

WILBUR H. HECHT
Attorney for Petitioner
Lybrand, Ross Bros. & Montgomery

Of Counsel:

MENDES & MOUNT
John F. Byrne

April 30, 1969